PROPERTY TAXES

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FOREWORD

THE general property tax is an essentially American institution, but not an institution of which we are inclined to boast. It has been condemned, as defective in principle and as impossible of administration, as long as American economists have been writing in the field of taxation. It has always proved troublesome to government officials. It has been the occasion of widespread taxpayers' strikes in recent years. The tax has never been used by the federal government, except for rare emergencies; and it has been abandoned as the major source of revenue by most state governments during the past decade. Local governments have been increasingly handicapped in their use of this tax by growing exemptions and narrowing rate limits. Yet the general property tax, or some modification of it, remains by far the largest source of tax revenue in the country today. There is good reason for the persistence of this form of taxation, and a real estate tax, at least, not only avoids the worst evils of the *general* property tax but has an important place in a sound tax system in this country today.

In view of these facts, the Tax Policy League decided that its 1939 symposium should be devoted to the consideration of the property tax and the many problems it has created. The program committee consisted of H. C. Loeffler, John A. Zangerle, and myself as chairman; with Harold S. Buttenheim and Mabel L. Walker as *ex officio* members.

The subjects selected for the different meetings were designed to focus attention on some of the more urgent problems. Those who prepared the papers were chosen because they were thoroughly conversant with the particular phase of the subject with which they were asked to deal, and in some instances, also because they represented divergent and important points of view.

We believe that the resulting papers, published in this volume, are a valuable contribution to the literature in the field, and will help to clarify and stimulate thinking on the still unsolved problems of the general property tax.

MABEL NEWCOMER,
Chairman,
Program Committee

PART ONE

TRENDS IN PROPERTY TAXATION

CHAPTER I

IMPORTANCE OF PROPERTY TAX IN STATE AND LOCAL TAX SYSTEMS

LEO DAY WOODWORTH

Tax Study Commission, State of Michigan

THE importance of this symposium on the subject of the ad valorem property tax is indicated by a few generalizations:

First, the tax yielded about $4.4 billion of the $12.3 billion of tax receipts in this country in 1939;
Second, although its ratio to total tax receipts has decreased almost one-fourth since 1928, the actual yield decreased only 7 per cent;
Third, it is the only substantial support for—and check upon—local municipal finances;
Fourth, it is perhaps the most naïvely and inequitably administered tax in this land of its nativity, and
Fifth, the rate of capitalization of the property tax tends to remain at two per cent of legal full value, while governmental revenue is being increased by levies on the basis of expenditures, principally by consumers.

The relation of general property taxes to municipal governmental activities, as the specific subject of this paper, may be defined as to scope by dissecting the title as stated in the program. This will be followed by some observations as to the financial value and the purpose of the levy, without invading the more specific topics of other speakers.

SCOPE OF DISCUSSION

The "importance" of any tax may be treated according to any of many viewpoints. It is here assumed to be the rela-

tion of the tax to the support of municipal government, whatever the nature or purpose of the activities that may be in vogue from time to time.

The "property tax" will be considered in its ordinary sense as a levy on taxable property according to the required percentage of capital value at a rate estimated to meet the uncovered expenditures of the tax district for the tax period.

"State and local tax systems" will be considered as a unified municipal system, except in certain statistical summaries of levies. This definition avoids the legal and practical error in the frequent reference to federal, state and local "levels of government," with corresponding distinction in functional, cost, and revenue distribution. In general, and waiving the legalistic objections to the word "level" in this connection, the relationship of federal and state governments is not comparable to those between the state and its minor subdivisions. The state as the original holder of sovereignty has surrendered specified powers to the federal government but not to its local units, however much it may be restricted as to the latter by its own amendable enactments, whether constitutional or statutory.

This contention for definition according to substance rather than as to form may complicate many tabulations of financial data, but it appears that over-simplification of the latter sometimes has resulted in figures that lead to false assumptions although in fact quite meaningless. The errors or omissions against which we here contend have been so common that a general explanation may be required, as follows:

(1) Starting with simple pioneer conditions where community activities, expenditures and levies were mutually

assumed and administered by residents without aid from beyond the town in the North or the county in the South, economic changes and political pressures [1] early began the gradual transfer of responsibility for services, costs and taxation from the community, usually to the commonwealth (state) but sometimes to intermediate (geographical) units or special (economic) districts. The nature of the public service was essentially domestic or personal in that it consisted in cooperative performance of acts incidental to home and society. These services grow along with size and congestion of population. The evolutionary process, however, has left imbedded in our customs and constitutions many elements that lend themselves neither to improvement in efficiency nor to conservation of the tax dollar.

(2) More spectacular in aspect but no more important in service or cost are the functions that pertain to the commonwealth rather than to the community. These budded with the need for great internal improvements a century ago. They grew in response to the various stages of the industrial age, and to the expanding frontiers of intelligence. However, the lag in the political as compared with the economic development is so apparent, and the present trend toward nationalization is so pronounced, that the eventual distribution of fiscal burdens and their tax implication are beyond definition at this time.[2]

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[1] This "pressure" usually results, of course, from electioneering promises to shift tax burdens without reducing benefits or increasing expenditures. The direct primary appears to have multiplied its scope. So far as the phrase relates to political groupings, the frequent reference to rural-urban conflicts in the legislatures of practically all states is too broad as analysis would seem to indicate that the real conflict is between differing political philosophies in the two areas or even in partisan organization and effectiveness, either present or potential.

[2] For example, one or more states, and many local communities, have yet to adjust their administrative as well as fiscal systems to federal withdrawal of property from the municipal tax base. The offer of federal payments in lieu of taxes (cf. Wylie Kilpatrick and Staff, *Urban Government,* Vol. I, Supplementary Report of the Urbanism Committee, National Resources Committee, Washington. Also by the present author in *Bulletin,* Nat. Tax Assn., Vol. XXII, p. 115) is perhaps the best plan that could be devised quickly, but the problems of municipal organization,

(3) Finally, the radius of daily transportation and of instant intercourse has abolished the old limits of community interest, political as well as economic, to the extent that a simplification in organization of local government is long overdue in the interest of required efficiency and the avoidance of costly waste.

TABLE 1

FEDERAL, STATE AND LOCAL TAX REVENUE (ESTIMATE)
FISCAL YEARS ENDING IN 1939

Excludes payroll taxes. Includes transfers from liquor monopoly funds[a]
(In Millions)

Classification	Federal	State	Local	Total	
				Amount	Percentage
Total	$4,744.3	$3,119.0	$4,450.8	$12,314.1	100.0
Property	$ 0.0	$ 190.2	$4,175.4	$ 4,365.6	35.5
Income	2,178.4	352.1	0.0	2,530.5	20.6
Motor fuel, registration	298.5	1,184.4	6.1	1,489.0	12.1
Liquor, tobacco	1,167.4	330.5	8.5	1,506.4	12.2
General sales and use	62.7	440.0	68.0	570.7	4.6
Death and gift	360.7	132.0	0.5	493.2	4.0
Customs	318.8	0.0	0.0	318.8	2.6
Other	357.8	489.8	192.3	1,039.9	8.4

Source: Tax Policy League, *Tax Yields: 1939*

[a] The sources of revenue sometimes must be reached under nomenclature or even by methods that are confusing to the student of taxation. This is necessary because of peculiar constitutional requirements or local political conditions. The present discussion pertains to financing of governmental functions. Hence the omission from this table of contributions for personal insurance against wage loss (payroll taxes) as also the receipts by employees' pension, workmen's compensation and other trust funds for non-governmental use. On the other hand the receipts into state operating funds from liquor monopoly funds are included.

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administration, and finance are unanswered, as are those of federal-state powers. Cf. *New York Times*, Dec. 10, 1939, as to the situation in Tennessee. Also "Government Expansion in the Economic Sphere: A review of the increasing economic functions of government." *The Annals*, CCVI (1939).

Reasons for Survival of Property Tax

The mere fact that the American ad valorem tax has survived and that it has been found useful under conditions that contrast strongly with those of its simple pioneer origin—in other words, that any such capital levy can be reconciled with modern tax theory and practice—is sufficient to place the student on inquiry.

Why has it been continued while it became less and less a measure of ability to pay for the costs of government? [3]

Why the failure of the assessed values to disappear, to "dry up," as would occur under an equivalent two per cent tax on intangibles?

Is the property tax more flexible than assumed by legislators and others, so that it differs in purpose and effect—in burden and benefit—in various communities?

Is there some relation between the tax and its purpose that is more direct than for other taxes? Or possibly some specific return to the taxpayer that reduces the confiscatory nature of this form of capital taxation?

Is it possible that part of the property tax sometimes ceases to be a tax for the support of the general functions of government? Does some portion partake of the nature of the non-tax special assessments for determinable benefits?

What is the significance of the hit-and-miss changes that have been adopted for its alleged improvement, most frequently for purposes of exemption in one form or another of all or part of the tax base?

Such are among the questions that are basic to discussion of the status of the property tax. The answers may be

[3] *Cf.* Herbert D. Simpson, "Changing Theory of Property Taxation," *American Economic Review*, XXIX, 453.

slow in coming as there is no private or governmental interest in discovering what makes the property tax work when it advances beyond the embryo stage of a mutual contribution at the town meeting. Does general acquiescence by payment result from good citizenship? Confidence in public officials? Belief that administrative controls are sound? Lack of inertia as to progress in governmental forms, services and personnel?

Replies to these and similar questions are beyond the scope of snap judgment, but we must note that any studies

TABLE 2

ESTIMATES OF STATE-LOCAL TAX COLLECTIONS

Exclusive of Payroll Taxes

(In Millions)

Fiscal Years Ending in	State			Local			State and Local		
	Total	Property		Total	Property		Total	Property	
	Amount	Amount	Percentage	Amount	Amount	Percentage	Amount	Amount	Percentage
1939[a]	$3,119	$190	6	$4,451	$4,176	94	$7,570	$4,366	58
1938[a]	3,208	196	6	4,538	*	..	7,746	*	..
1937[a]	2,996	213	7	4,566	*	..	7,562	*	..
1936	2,578[a]	186[a]	7	4,568[a]	4,300†	94	7,146[a]	4,486†	63
1932[b]	1,642	324	20	4,716	4,361	93	6,358	4,685	74
1928[c]	1,507	381	25	4,641	4,314	93	6,148	4,695	76
1927[c]	1,355	370	27	4,367	4,061	93	5,722	4,431	77
1922[d]	868	348	40	3,353	2,973	89	4,221	3,321	79

* Not compiled.
† Estimated.
[a] Tax Policy League, *Tax Yields, 1939.*
[b] Bureau of the Census, *Financial Statistics of State and Local Governments: 1932.*
[c] National Industrial Conference Board, *Cost of Government in the United States, 1928–1929.*
[d] Bureau of the Census, *Wealth, Debt and Taxation: 1922.*

that may be undertaken will be limited by the records and reports. These are the despair of the investigator. As a rule they are inadequate, always open to question, and broad improvement is not now in prospect.

The condition of American fiscal data could not be worse if deliberately prepared for purposes of concealment and evasion. Uniformity in classification of data put out by units of government, by different agencies within units, and by each new director of a unit or agency, is practically unknown. Totals are compiled, charted, and compared without regard for conclusions that may be drawn, not only by economists and students of government, but by legislators and citizens. Evidence to sustain this indictment can be produced by every worker in the field of taxation, particlarly in the case of the property tax, but most of us can be charged personally with too much independent reasoning even while striving to overcome the limitations of our predecessors, or to supply new breakdowns to meet new conditions.

Unfortunately, our basic data are generally from governmental sources that lack appreciation of the importance and use of even the most trivial tabulations. Furthermore, the officials in the costly field of municipal government seem to seek shelter [4] in concealment through inadequacy *or absence* of necessary records—the exceptions indicating the rule in this situation!

With these words of caution, it may be well to treat briefly of two specific phases on which sufficient data are

[4] Statistics are notably lacking that would reveal the vast inequities to taxpayers from delinquency, exemption, remission or omission that pervade the administration of the property tax in many areas—the few exceptions emphasizing the general practice. But even so, such statistics are better than exist for the many other taxes for which the collection agencies make no pretense of reporting the uncollected taxes, as on sales, severance, estate, corporation or other bases.

available to indicate volume and trend even if amounts are subject to some change.

Fiscal Significance of Property Tax

The fiscal importance of the yield of the property tax is indicated by the fact that collections from that source amounted to about $4.4 billion or 35 per cent of all federal, state and local, 58 per cent of all state and local, and 94 per cent of all local tax revenue in this country in 1939 (Table 1).

The federal government derives no revenue from the property tax as here defined, although it has many new relations to its operation. These should be the subject of a more definitive study than any that have been made or are now in progress.[5] Perhaps the federal expenditures in all communities are so generous in amount as to justify exemptions for the lifetime of federal proprietary improvements, or perhaps they are not, but that is not the most important question. The relations of federal policies to municipal finance should be thoroughly explored as proposed in the last session of Congress.[6]

The revenue from the property tax for state activities

[5] *Financial Statistics of State Governments, 1937*, Bureau of the Census. *Cf. Facing the Tax Problem*, Twentieth Century Fund, Chap. 7, and the companion volume, *Studies in Current Tax Problems*. Reference in the text is to studies of the Urbanism Committee of the National Resources Committee (Footnote 2, *supra*) and to research by the several agencies that deal with loans, grants and contributions, with construction projects and resources development, or with federal facilities and national lands. Also *cf. Conflicting Taxation*, the 1935 Progress Report of the Interstate Commission on Conflicting Taxation, James W. Martin, Director.

[6] H. J. Res. 35, 76th Cong. 1st Sess., Jan. 3, 1939. *Cf. Fortune*, May, 1939, for round table discussion of Taxation and Recovery which agreed that "Our first and foremost suggestion is that Congress authorize the appointment of a national tax commission, drawn from among the ablest men in public and private life" that "could recommend to Congress a comprehensive tax system that would provide the revenue necessary for America's social and fiscal needs."

has decreased substantially in both amount and percentage, or from 27 per cent in 1927 to 6 per cent in 1939 (Table 2), although state expenditures have nearly doubled in that period, principally for services acquired from, and for grants or centrally collected taxes paid to, the localities to supersede or to avoid local property levies.

Many states levy no property tax for state purposes, but their removal from the field of property taxation seems to have eliminated the one force that could have been expected to level the peaks and valleys in efficiency of property tax administration in the local districts. There is some reason to believe that the loss has been more than the gain in most states where the change has been made.

The counties and minor subdivisions derive 94 per cent of their self-collected tax revenue from this source as they did a decade ago (Table 2) although the fiscal picture is being changed by the increasing amount of grants-in-aid. For example, the ratio of property tax collections to total receipts from all sources by Oklahoma counties and minor units has been as follows:

Units	*1931–32*	*1934–35*	*1936–37*
Counties	56.00%	60.94%	55.02%
Cities and towns	49.18	52.52	43.59
School districts	73.07	64.50	55.41
Townships	97.63	89.66	86.78
Totals	62.33%	60.37%	52.34%

In all the states the local tax revenue—i.e., the tax collected by local authority—is from the direct levies on property, and the amount of the tax is little less than the peak collection of $4.7 billion in 1932, notwithstanding a flood of new legislation to increase exemptions, to restrict levies and to encourage delinquency. Recent collections have bene-

fited from the backlog of delinquency that reached its greatest percentage of current levies about 1933 when $909 million were reported uncollected on levies of $4.4 billion against property valued at $139 billion,[7] or a national average rate of 3.2 per cent on assessed values. If values were adjusted to an approximation of the fair value contemplated by the law, the average rate of tax would have been about 2 per cent on an aggregate assessment of about $200 billion.[8]

No tax is self-administering and administrative difficulties are quite possibly the result of and proportional to the pains inflicted upon both the taxpayer and the elected officials. The measure of administrative efficiency must, however, be the percentage of delinquency, and that is the combined effect of legislative acts and of enforcement pro-

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[7] Lent D. Upson and Leo Day Woodworth, *Realty Tax Delinquency, 1934*, Bureau of the Census (mimeographed releases); the general tables appear in *National Tax Association Proceedings, 1934*; for state summary table, see *Tax Systems of the World*, 6th ed., p. 119 and 7th ed., p. 136. Urban data from 1930 is presented annually by Frederick L. Bird in studies entitled, *Trend of Tax Delinquency*, issued by Dun & Bradstreet, New York. It seems proper to record somewhat belatedly the indebtedness of the directors of the above Census project to many other persons, particularly to Messrs. Brownlow and Chatters who obtained its inclusion in the CWA program, to Messrs. Austin, Rice and Gray of the Census Bureau, and to preliminary analyses of tax delinquency by Professors Jensen, Fairchild and Simpson, as follows: Jens P. Jensen, "Delinquent Taxes," *National Tax Association Proceedings, 1930*, p. 228; Fred R. Fairchild, Chairman Reports of the Committee on Delinquent Taxes, *National Tax Association Proceedings, 1932*, p. 292, and *1933*, p. 277; Herbert D. Simpson, various articles including discussions that followed the committee reports as cited.

[8] Based on the author's unpublished study of the assessment year 1933. The wide variation in assessment ratios as between tax districts and between classes of property within any one district, if Federal Housing Administration appraisals are accepted as standard, is shown in *Residential Property Assessment in Indiana*, 1938, Inter-Organization Council of Indiana, Indianapolis. Quoted in *Staff Studies of the Tax Study Commission*, Michigan, Vol. 3, p. 546 *et seq.*, articles on general property tax by this author.

cedure—and a certain amount of public indifference. Here is a problem which has developed in most states within about forty years. It has an elemental relation to the subject of this conference but will be dismissed so far as this paper is concerned by reference to the implications in the following extract from an official report. Referring to lands bid in by the public after persistent tax delinquency, the report recites conditions that have their counterpart in other jurisdictions:

> Our investigation of the present system covering state owned lands revealed that the [state] office had no information whatever relative to the type, class or improvements on properties that had been purchased through tax sales, the only record available being the legal description of a particular parcel, the name of former owner and the amount of taxes that were due at time of sale. Our study revealed that the State Tax Commission did not, unless in some exceptional case, make any attempt to take charge of the many properties bought in at tax sales, and while many of these properties constituted hotels, office buildings and apartment houses and other valuable buildings, no attempt was being made to collect rentals that the various properties were bringing. There is no doubt but that the rentals were being received by the former owner or some mortgagee who had taken charge of the property. It is our opinion that this condition alone has probably invited many property owners to become lax in the payment of their taxes and to allow certain properties to be sold.[9]

Application of Property Tax

The application of the general property tax in our governmental system may be sketched to indicate not only (a) fiscal importance in various types of municipalities but also (b) the problems that are involved in its replace-

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[9] *Report* of the Joint Recess Committee on Ad Valorem Taxation and Homestead Exemption, 1935. Ala. Leg. Doc. No. 12, Reg. Sess. 1935, p. 8.

ment, modification or standardization (fixation, limitation).[10]

The distribution of property taxes between a state and its local units has already been noted in the consideration of the yield. Here it is proposed to indicate the functional use of the tax, or rather the use of the receipts through our antiquated[11] collection and enforcement methods. These methods to a considerable extent are based largely on custom, modified at important points by opportunist legislation,[12] and nowhere operating throughout under a planned code of procedure. The situation in the several states is sectional in form and results, as well as within sections and even within states. The tax collector of New England does not understand the pother about delinquency as discussed in central and western states as both he and the property owner understand that enforcement will be strict. Until recently the collectors in Maine were under bond to return

[10] Forerunner of the current movements to (a) abolish the property tax, notably in Michigan and Florida, or (b) to establish over-all limitations on a state-wide basis, notably in Ohio, Michigan and Washington, or (c) to remove personalty from the general property tax base by classification for specific taxation, notably in New York, was a proposal being considered by a New York group in conference with the late Edwin R. A. Seligman for property levies limited to a predetermined percentage of the municipal budget. Some groundwork for such a proposal may be noted in a contemporary address by Dr. Seligman. *State Conference on Taxation,* New York, 1919, p. 13. Preliminary thereto was an unpublished study on the subject for the Advisory Council of Real Estate Interests in New York by H. A. E. Chandler (1918).

[11] "The present property tax administration (Mich.) is handicapped by a decentralized pattern of assessment districts, weak personnel and a complicated and awkward procedure." Robert S. Ford, *Property Tax Procedure,* Bureau of Government, University of Michigan. *Cf. Facing the Tax Problem, op. cit.,* p. 431; *Report of the New York State Commission for Revision of the Tax Laws,* 1932 (Haig, Shoup); *Report of the Connecticut Temporary Commission to Study Tax Laws* (Fairchild), 1934; and innumerable other official and private statements.

[12] A case in point on opportunism is that of the unique 1940–44 salvage sales to be held in Michigan, if the compromise between up-state conservation and down-state investment interests can pass the uniformity and other constitutional tests.

either the cash or the property. In many states, however, delinquency means not loss of property but a means of evasion by the wise.

This apparent digression is inserted to indicate the possible error in comparative data, even as between urban centers that are equipped with more or less competent collection systems. Even here a proper classification might

TABLE 3

AVERAGE TAX RATES IN 257 CITIES, 1939
WITH EQUIVALENT OF ASSESSMENT RATIO 100%

Cities	Population	Levied	100% Value
13	Over 500,000	$39.80	$29.38
12	300,000 to 500,000	43.63	29.50
67	100,000 to 300,000	40.48	28.73
74	50,000 to 100,000	37.34	26.54
91	30,000 to 50,000	41.52	27.02
257	General Average	$40.07	$27.57

Source: Same as Table 4.

distinguish between those which both vote and collect their own levies and those which only vote the budget, leaving the enforcement to the county or even in part (e.g., on delinquency) to the state. Levies by cities in two states [13] may be upon valuations set by townships therein. These factors and others—such as the effect of allowing the taxpayer to choose which of his overlapping levies he will pay and which not—can only be referred to as important but not well studied.

These administrative differences may be quite as important as the usual frailty of estimated assessment ratios in

[13] Illinois and Indiana.

attempts to compare tax rates and per capita burden in cities, large or small.

The property taxes in cities of over 30,000 population have been reported by the Bureau of the Census as over 80 per cent of the national aggregate of property taxes.[14] As the rate determines the burden in any particular locality, it may be noted that the available data indicate an average levy in 1939 of 2.76 per cent of estimated full value, or an average of actual levies of 4.01 per cent, in 257 reporting cities of over 30,000 population each. (Table 3) In the 13 cities with over 500,000 population each, Washington excluded, having an aggregate population of 22 million and general property tax receipts of $1.1 billion in 1936,[15] it appears that estimated actual property tax rates ranged from 2.02 per cent (San Francisco) to 3.99 per cent (Boston) in 1939, the actual rates levied being from 2.72 (Philadelphia) to 9.12 (Chicago) in 1939. (Table 4) The comparability of rates in any two cities or other units, however, is limited by such unrevealed differences as

(a) Distribution of functions between the city and other units, whether overlapping or subsidiary;
(b) Method of financing beneficial services, whether from general tax, special assessment or privately;
(c) Extent, form and cost of debt service, including credit factors;
(d) Credits or debits that result from utility and other proprietary ventures.
(e) Relation of geographic to economic boundaries, for increased density of population increases costs while taxing powers may end at the city line.

But other differences that are more significant although less tangible include:

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[14] Bureau of the Census, *Financial Statistics of State and Local Governments, 1932.*
[15] Bureau of the Census, *Financial Statistics of Cities, 1936.*

(f) Comparative ratios of property taxes to other taxes paid by the same class of taxpayers for similar services. In other words, assuming a uniform set of governmental functions in the units to be compared, do the owners of taxable property pay more or less under the combined impact of the tax system, if the ratio of the property tax to other taxes is increased—or decreased?

(g) Extent to which local taxable capacity is drawn upon for the benefit of other communities, for any reason whatsoever.

The last of the differences to be mentioned is

(h) Activities included in the municipal budget, their number, powers, development and administration. This factor cannot be ignored whether the comparison involves size, date, valuation or location. For example, a tabulation for Detroit shows a growth in activities from an original 23 (1824) to 306 (1930) with increases in taxes, debt and population as shown in Table 5.

TABLE 4

CITY TAX RATES, ACTUAL AND AS LEVIED, 1939
CITIES OVER 500,000 POPULATION

City	Tax Rate		Actual on 100% Value		
	Levied [a]	Rank	Assessment Ratio [b]	Rate	Rank
Chicago	$91.20	1	37	$33.74	3
Los Angeles	55.89	2	50	27.95	8
San Francisco	40.40	3	50	20.20	13
Boston	39.90	4	100	39.90	1
Buffalo	39.70	5	84	33.35	4
Milwaukee	37.83	6	90	34.05	2
Pittsburgh	35.60	7	80	28.48	7
Detroit	33.33	8	100	33.33	5
Cleveland	30.20	9	80	24.16	11
New York	29.50	10	92	27.14	10
Baltimore	28.84	11	100	28.84	6
St. Louis	27.70	12	85	23.55	12
Philadelphia	27.25	13	100	27.25	9

Source: Arranged from Mohaupt, "Comparative Tax Rates," *National Municipal Review*, Dec., 1939.

[a] Rate may be for year of collection and not of assessment.

[b] Assessment ratio is as estimated to compiler by local officials and in many cases probably is too high.

TABLE 5

COMPARATIVE DATA, CITY OF DETROIT

Year	Population	Activities Distinguished	Per Capita Debt	Per Capita Tax Levies
1860	45,619	46	$ 20.92	$ 4.50
1880	116,340	74	20.96	8.64
1890	205,876	102	9.45	12.36
1900	285,704	132	15.50	12.82
1910	465,766	170	15.55	14.64
1920	993,687	251	26.85	35.31
1925	1,246,044	281	129.72	45.11
1930	1,573,985	306	175.29	48.33

Source: Lent D. Upson, *The Growth of City Government*, Detroit Bureau of Municipal Government (1931). Other cities have similar tabulations.

These points are noted to indicate not only the importance of the property tax, but the variation in that importance from time to time, from place to place, and the dangers in generalizing in conclusions from available data beyond the apparent fact that the property tax is not for the same purpose, of similar weight, or perhaps with the same form in any two places. Legislation too often is framed without due appreciation of this fact.

It is impossible in this place to attempt to project the data for changes that may be near at hand in the scope and form of municipal government. Referring particularly, however, to the situation as it affects real property which tends to become the sole base of the property tax, it may be well to call attention to problems that call for more than superficial attention. Some of these have received relatively isolated study. Some are in the hands of specialists whose work is basic to constructive coordination at some time by an encyclopedic mind.

First, the general property tax has built and until recently has operated the facilities of our urban centers where the acute problems of the property tax are developing, where tax strikes generate, where opportunist measures of tax relief receive popular support.

As to this, two things are happening: City population is changing in type, arrangement and taxable capacity, while city plan and facilities are becoming obsolete. Combine the two in our thought and the great problems of the future in municipal finance begin to appear.

Second, the recent experiments in replanning, reconstructing and financing have provided more lessons by way of caution than of improvement. One important lesson is that taxation is not an isolated function of government, however cruel its manifest injustices. It is ancillary to what it supports. It has a cause as well as a form. It relates back to the elaboration of facilities whether they are services or outlays (permanent plant), but it also relates to future rectification of boundaries and the modernization of administration. Reforms are mere palliatives when they are limited to mere shifting of the tax burden, especially when it is only a shifting of payments as from one pocket to the other of the same taxpayer.

Third, most recent legislation under such slogans as to "relieve real estate," or to "broaden the tax base," or even to "equalize educational opportunity" as also the now competing urge to provide "good roads" or the like—and these objectives are all within the scope of facilities long ripe for overhauling and improvement as indicated above—tends to separate the political responsibilities for spending and for taxing. Removal of joint responsibility for scope and cost of government cannot avoid elimination of the only civic check not only on waste but on fossilization. Removal

eliminates all encouragement for the exercise of ability, endeavor and invention—these virtues being the essence of our American system.

Fourth, evidence is not conclusive that payers of the property tax will gain as often expected by a shift of their distinctly municipal burdens to overlapping governments.[16] Grants-in-aid have their uses in forcing desired social advances but as a practical tax problem, Who pays? Will not such a shift bring back the cost to approximately the same taxpayers either in taxes or in effects on wages and employment, or both?

Fifth, the tax economist is forced to consider the present inflexible system of municipal administration, whether state or local. It seems to be a condition that is as unavoidable as it is universal in the American system of representative government. It behooves the tax system to be as regular in the production of revenue. Yet the substitutes for the property tax now known to fiscal science are based principally on either private income or private expenditures, both of which fluctuate widely with business conditions. To bridge the peaks and valleys of indirect taxes by borrowings will only involve the property tax still further.

The only reasonable conclusion appears to be that the great or even imperative need in tax legislation today is for a better property tax—a property tax based on fair equalization of capitalized values.

[16] *Cf.* J. Roy Blough, L. Laszlo Racz and William J. Stauffer in *Tax Relations Among Governmental Units.* "Nobody's money," or funds for which no political official accepts responsibility, results from grants being neither local taxes nor within state official control. John M. Pierce, *National Tax Association Proceedings, 1939,* also *Tax Digest,* XVIII, p. 413. At the 34th Annual Meeting of the Municipal Finance Officers' Association of the United States and Canada (1939), City Comptroller Armstrong of Birmingham emphasized that "local government cannot be dependent and independent at the same time." A similar fiscal note was sounded in the recent presidential address to Section F of the British Association. *Economic Journal,* XLIX, 407.

CHAPTER II

REAL PROPERTY AS A TAX AND REIMBURSEMENT BASE DURING THE DEPRESSION[1]

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ALTHOUGH there seems to be no agreement regarding the exact time period covered by what is commonly referred to as "the depression," the subsequently presented property tax data relate, in the main, to the crucial years after 1929.

The property tax materials are presented with a view of: (1) relating the behavior of real estate to that of other wealth phenomena; (2) inquiring briefly into some of the probable causes underlying the changes in the relation between real property and other forms of wealth; (3) appraising the probable future stability of the changed relationship between real property and other indices of welfare, and (4) evaluating the significance of the ascertainable changes of the order indicated upon the reasonably expectable, absolute and relative yield of realty as a tax base. In similar manner an attempt will be made (1) to trace changes in the relative significance of realty as a reimbursement base, (2) to suggest some probable causes

[1] Although this article was prepared while the writer was associated with the Social Security Board, Washington, D. C., in a consulting capacity, responsibility for facts presented and views expressed rests exclusively with him. The computations, unless otherwise accredited, have been made by Dr. Clyde H. Graves under the direction of the writer.

responsible for such changes as are observable and, (3) to indicate the objectives which seem susceptible of attainment by the use of realty as a reimbursement base. Though, subsequently, an attempt will be made to show that there obtains an intimate relation between the tax base and reimbursement functions of realty, the two aspects will be dealt with separately.

Realty As A Tax Base

Local tax collections from real estate declined from approximately four billion 337 million dollars in 1929 to about three billion 744 million dollars in 1934. Though local collections improved somewhat after 1934, they apparently never again reached the 1929 figure.[2] The behavior of the yield from state taxes upon realty exhibits a still more pronounced downward trend. Realty taxes, as state revenue producers contributed an estimated 27 per cent of state tax collections in 1927. In 1932, they contributed about 19 per cent, and in 1937, their estimated relative contribution fell to an all time low of approximately seven per cent.[3]

The decline of the relative importance of real property as a revenue producer has been accompanied by mounting delinquencies, which, on the basis of a sample study, apparently increased roughly 100 per cent.[4]

[2] National Industrial Conference Board, *The Cost of Government in the United States, 1935–1937*, p. 30. Local tax collections from real property have been estimated at 90 per cent of total local tax collection. *Cf.*, Jensen, J. P., *Property Taxation in the United States*, Chap. I.

[3] From United States Department of Commerce, Bureau of the Census; *Financial Statistics of States, 1927*, p. 64; *Financial Statistics of State and Local Governments, 1932*, p. 7; *Financial Statistics of States, 1937*, p. 2. In calculating the percentage for 1937, the state unemployment compensation taxes, amounting to $346,770,000 have been subtracted from the states' sum total of tax collection in order to assure comparability.

[4] Gardner, J. E., "Delinquent Taxes in Ohio . . . ," *Bulletin of the National Tax Association*, XXV, 6. Also, Allen, H. K., "Chronic Tax Delinquency Presents a Challenging Problem," *Bulletin of the National Tax Association*, XVI, 270.

Though the fiscal importance of the property base has declined, complaints regarding the "burden" of the realty tax have multiplied manifold.

Legislators from coast to coast responded to delinquencies and clamor by providing for over-all realty tax limits and miscellaneous "emergency" levies—notably retail sales taxes. Homestead exemption laws and government purchases of land, combined to accentuate still further the precarious position of real estate as a revenue producer.

In the light of these developments whose contours are common knowledge, it seems permissible to attempt to investigate some of the factors that seem primarily responsible for the changed position of real estate as a tax base.

A priori, it would appear that if the relative importance of realty as but one form of wealth can be determined with reasonable certitude, the depression behavior of the realty tax may be more realistically evaluated. More specifically, any evidence which facilitates a reasonable fixation of the trend of real estate value relative to other value phenomena trends will indicate whether or not the recent behavior of realty as a tax base presents but a depression aberration or the accentuation of a long-range development.

It would seem worth one's while to attempt what must of necessity be but a tentative answer to this all-important question, because policy makers have shown an unprecedented indulgence for statutory fiscal enactments which they choose to label "emergency measures." It goes without saying that to the extent that the protective label "emergency measure" is used in good faith, policy makers, in the face of rising public expenditures, are proceeding upon the assumption that the recent behavior of the realty base is but a temporary phenomenon and likely to be nontypical of the years ahead.

Perhaps one of the more significant clues to the behavior of realty as a tax base is to be found in the behavior of (a) net capital formation, *exclusive* of net capital formation traceable to the activities of governments and (b) net capital formation traceable to private residential construction activities.[5]

Table 1 presents: (1) national income produced, (2) income paid out, (3) net capital formation exclusive of net capital formation traceable to governmental activities, (4) net capital formation originating in residential construction, (5) population, (6) assessed valuation of real property, and (7) total state and local tax collections.

Inspection of Table 1 (col. 7) shows that estimated assessed valuation of all real property subject to taxation increased from 111 billion dollars in 1926 to 129 billion dollars in 1931. In 1932, however, the assessed valuation of taxable realty began to decrease until it reached a low of an estimated 102 billion dollars in 1934. Again, the increase in assessed valuation between 1926 and 1931 amounted to approximately 4 billion dollars per year, whereas the decrease between 1931 and 1934 amounted to approximately 10.4 billion dollars per year. In other words, the decrease after 1931 more than compensated for the increase between 1926 and 1931.

Similarly, inspection of the table indicates that net capital formation, of which net capital formation originating in construction constitutes an integral part, declined con-

[5] Net capital formation traceable to governmental activities, though of substantial magnitude relatively speaking in the recent past has been omitted, because, typically, such net capital formation, even though it takes the form of realty does not become part of the tax base. It would have been desirable to show net capital formation traceable to private non-residential construction, but business balance sheet practices which frequently do not provide for a detailed breakdown of the item "capital assets" make it exceedingly difficult to obtain meaningful basic data.

TABLE 1

INCOME PRODUCED, INCOME PAID OUT, NET CAPITAL FORMATION EXCLUSIVE OF NET CAPITAL FORMATION TRACEABLE TO GOVERNMENT ACTIVITIES, NET CAPITAL FORMATION ORIGINATING IN RESIDENTIAL CONSTRUCTION, POPULATION, ASSESSED VALUATION OF REALTY, TOTAL STATE AND LOCAL TAX COLLECTIONS

(In Millions)

Year	Income Produced	Income Paid Out	Net Capital Formation	Net Capital Formation Residential Construction	Population	Assessed Valuation of Realty	Total State and Local Tax Collections
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1926	$77,251	$72,823	$ 7,680	$2,518	116.5	$111,396	$5,398
1927	79,101	73,381	6,737	2,186	118.2	112,488	5,722
1928	80,417	75,823	6,047	1,848	119.9	120,138	6,148
1929	78,920	79,808	7,611	530	121.5	125,645	6,431
1930	70,791	73,620	1,151	− 626	123.1	127,485	6,798
1931	56,193	62,565	−2,164	− 825	124.1	129,393	6,583
1932	44,974	49,785	−5,887	−1,382	125.0	125,933	6,358
1933	42,253	47,880	−4,125	−1,360	125.8	104,795	5,715
1934	46,722	52,385	−4,998	−1,415	126.6	101,820	5,881

Sources: Cols. (2), (4) and (5) from Kuznets, Simon, *Commodity Flow and Capital Formation*, Vol. I, pp. 494 and 498.

Col. (3), Kuznets, S, *National Income and Capital Formation 1919–1935*, p. 18.

Col. (6), *Statistical Abstract of the United States, 1938*, p. 10.

Col. (7). Data for 1927 through 1932 from United States Bureau of the Census, *Financial Statistics of States;* 1927, p. 124; 1928, p. 120; 1929, p. 122; 1930, p. 122; 1931, p. 116; 1932, p. 64. Data for remaining years estimated on the basis of, Wueller, P. H. and Associates, *The Fiscal Capacity of the States: A Source Book*, Table I, Alabama–Wyoming.

Col. (8). National Industrial Conference Board, *Cost of Government in the United States, 1935–1937*.

sistently over the period under investigation. Though this decline became accentuated over the period between 1929 and 1939, it had been already in evidence during the period between 1926 and 1927. This last mentioned tendency is the more interesting, because it was taking place during an interval of time when income produced was slightly in-

creasing. The change in relationship between national income and net capital formation would seem to suggest that already in the period of the twenties, less and less of the national net product was devoted to the production of capital instruments including privately owned taxable real property.

Further perusal of the table would seem to suggest that the tendency for the ratio of "net capital formation" to "national income" to decline is particularly pronounced as regards capital formation originating in residential construction. Inspection of the table indicates that (1) income paid out (col. 3) declined less rapidly than income produced (col. 2), and that (2) net capital formation originating in residential construction declined persistently though income paid out actually increased over the period 1926–29 and again in the period 1933–34. This behavior would seem suggestive, because consumption patterns being given, changes in income paid out, taken in conjunction with population changes probably constitute the most important variables in the demand function for residential real estate. If this reasoning is accepted, it would appear, particularly in view of the fact that population is increasing at a decreasing rate (col. 6), that at least such fraction of the realty base as consists of residential realty is not likely to regain its traditional position in the immediate future.

Some of the implications of the restoration of the real estate tax to its former role may be visualized if the behavior of the assessed values of taxable real estate is related to the behavior of state-plus-local tax collections. It will be observed that state-plus-local tax collections (col. 8) increased from 5 billion 398 million dollars in 1926 to 5 billion 881 million dollars in 1934. In 1927, taxable real estate contributed approximately 75 per cent of total state-

plus-local tax collections. On the basis of an assessed valuation of 112 billion dollars (col. 7), the contribution of realty required a mean nominal rate [6] of $38 per thousand. If in 1934, realty had been called upon to contribute 75 per cent of the total state-plus-local tax collection, the mean nominal rate would have been $43 per thousand.

It goes without saying that the above computation severely understates the additional load which realty would have been called upon to bear had it continued to bear its proportional share of state-plus-local revenue requirements. During the period under investigation, federal grants to the states increased from $102,125,000 in 1927 to $1,803,580,000 in 1934.[7] The difference between dollar amounts of federal grants to the states in 1927 and 1934 should be added to state-plus-local tax collections if the aim is an approximate but realistic measure of the increase in state-plus-local revenue requirements. Adding this difference [8] to state-plus-local tax collections, the increase in state-plus-local revenue requirements between 1927 and 1934 amounts to $1,701,-455,000. Had realty been called upon to bear its proportional share of this increase, it would have had to be taxed at a mean nominal rate of $60 per thousand.

To summarize briefly previously made observations regarding the trend behavior of realty as a tax base, the following reflections seem warranted by the evidence. First, the rate of increase of capital values including realty,

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[6] For the purpose in hand "mean nominal rate" is defined as the ratio of "total tax collections from realty" to "total assessed valuation of realty."

[7] See Table II. In passing it may be observed that federal grants to the states continued to increase at an increasing rate. *See* Wueller, P. H., and Associates, *op. cit.,* Table I, Alabama-Wyoming, cols. 14 and 15.

[8] *See ibid.,* Tables S I-S IV, inclusive. The difference is computed on the basis of all federal aids, including direct relief and WPA outpayments in states. Federal grants to states for 1927 from, Bitterman, H. J., *State and Federal Grants-in-Aid,* p. 193.

already showed a tendency to decline prior to 1929. Second, the value of the year by year ratios "net capital formation including realty" to "income produced" declined without interruption throughout the period. In the light of this evidence, coupled with the trend behavior of population and the changing relation of "income paid out" and "net capital formation," realty as a tax base cannot reasonably be expected to assume its traditional role unless either the trend of governmental expenditures is reversed or realty rates are progressively increased.

If these conclusions are accepted, it would seem that the fiscal situation arising from failure of realty as a tax base to provide its traditional share of revenue can no longer be regarded as a passing "emergency." By the same token, it would seem sound and realistic policy to evaluate seriously alternative levies, which could be geared more adequately to the changing structure of a dynamic economy.

Realty As a Reimbursement Base

Real estate in addition to being used as a tax base is also employed as a reimbursement base or reimbursement determinant.

For the purposes of this discussion, realty is considered as a reimbursement base or reimbursement determinant whenever the volume of funds transferred from one jurisdiction to another is some function of the value of the realty taxable by the receiving jurisdiction, provided the funds transferred have not accrued to the awarding jurisdiction in consequence of the imposition of a shared tax.

Realty as a reimbursement determinant is pressed into service in connection with the awarding of grants-in-aid. It is the purpose of the subsequent discussion to ascertain changes in the position of real estate as a reimbursement

determinant. More specifically, an attempt will be made to show: (a) changes in the volume of funds which are wholly or partially allocated on the basis of real estate taxable by the receiving jurisdiction, and (b) changes in the number of jurisdictions that use realty as a reimbursement base.

By way of introductory observation, it may be noted that

TABLE 2

LOCAL TAX COLLECTIONS, STATE GRANTS TO LOCALITIES, STATE TAX COLLECTIONS, FEDERAL AIDS TO STATES: 1925–1935

(Dollar Figures in Millions)

Year	Local Tax Collections	State Grants-in-Aid	Col. 3 as Percentage of Col. 2	State Tax Collections	Federal Grants-in-Aid	Col. 6 as Percentage of Col. 5
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1925	$3,811	$340.6	8.9	$1,107	$113.7	10.3
1926	4,134	[a]	[a]	1,264	107.9	8.5
1927	4,367	[a]	[a]	1,355	102.1	7.5
1928	4,641	381.4	8.2	1,507	102.1	6.8
1929	4,819	[a]	[a]	1,612	138.8	8.6
1930	5,018	[a]	[a]	1,780	134.4	7.6
1931	4,805	[a]	[a]	1,778	217.8	12.2
1932	4,716	518.7	11.0	1,642	248.9	15.2
1933	4,210	565.0	13.4	1,505	501.8	33.3
1934	4,160	673.8	16.2	1,721	1,803.6	104.8
1935	4,299	773.1	18.0	1,886	2,629.9	139.4

Sources: Col. (2) and Col. (5) from National Industrial Conference Board, *Cost of Government in the United States, 1935–1937*, p. 30.

Col. (3) and Col. (6) for the years from 1925 to 1929 from Bitterman, *op. cit.*, p. 54 and p. 133. Col. (6) for 1929 to 1935 calculated from Wueller, *op. cit.*, Tables S,I–S,V and Table I, Alabama-Wyoming.

The federal grant figures for the years from 1925 to 1928 include federal outpayments for the following functions: Agricultural colleges and experiment stations, agricultural extension, forestry aids, vocational education, education and rehabilitation, public, maternal and child health and highways. The figures for the remaining years, in addition to the above-enumerated items, contain payments to states for general relief and federal payments within states for WPA purposes. The last two items represent outpayments for essentially new functions.

[a] Not accessible.

the total volume of funds distributed in the form of grants-in-aid has increased considerably over the period from 1925 to 1935.

Table 2 shows, in terms of dollar amounts, both state and federal aids for the period from 1925 to 1935.

Inspection of Table 2 indicates that, in terms of dollar amounts, federal aids to the states increased from $113,-700,000 in 1925 to $2,629,900,000 in 1935. In other words, federal aids in 1935 were approximately 23 times as large as in 1925. Over the same period state grants to the minor jurisdictions increased from $340,600,000 to $773,100,000. This increase, though substantial, did not nearly approximate the rise registered by federal aids.

It is likewise interesting to observe that whereas state grants, expressed as percentages of local tax collections climbed slowly from 8.9 to 18.0, federal aids expressed as percentages of state tax collections rose steeply from 10.3 to 139.4. In other words, in 1935, federal aid to and in states approximated one and two-fifths of state tax collections.

It is common knowledge that as regards federal aids to the states, the value of real property taxable by the states is not used as a reimbursement determinant.[9] Inasmuch as the average yearly volume of federal aids between 1930 and 1935 has been $920,000,000 as compared with an average yearly volume of $110,000,000 between 1925 and 1929; whereas the average state grant volume for the two periods in question has been approximately $600,000,000 and $350,-

[9] This is not to imply that federal administrators of some of the lapsed programs have never consulted realty valuations when determining relative allocations of federal funds among the states. *Cf.*, Clague, E., and Gordon, J., *Earmarking of Tax Funds for Welfare Purposes,* p. 3. It has been rumored from time to time that such has been the practice. Nevertheless, value of state realty as a reimbursement determinant has apparently never found its way into federal statute.

000,000, respectively, the conclusion is irresistible that realty as a reimbursement base has appreciably declined relative to the total volume of grants and aids.

The table below indicates that a decline of the relative importance of realty as a reimbursement determinant is likewise observable on the state-local level.

TABLE 3

TOTAL STATE GRANTS-IN-AID, STATE GRANTS-IN-AID FOR SCHOOLS, SCHOOL GRANTS AS A PERCENTAGE OF TOTAL GRANTS, 1925–1935[a]

(Dollar Figures in Millions)

Year	Total State Grants-in-Aid	State Grants-in-Aid for Schools	Aid for Schools as Percentage of Total Grants
(1)	(2)	(3)	(4)
1925	$340.6	$254.1	74.6
1928	381.4	323.1	84.7
1932	518.7	397.4	76.6
1933	565.0	368.8	65.3
1934	673.8	446.3	66.2
1935	773.1	521.8	67.5

[a] Adapted from Bitterman, *op. cit.*, p. 54.

Inspection of Table 3 indicates that the percentage of total state grants to localities represented by school aids has declined from 74.6 in 1925 to 67.5 in 1935.

It should be observed that the amounts awarded for school purposes are identical with the maximum amount possibly redistributed by reference to the real estate taxable by grant receiving jurisdictions, because, with but quantitatively insignificant exceptions, only school grants employ realty as a reimbursement determinant.[10] Hence, it follows

[10] Hinckley, R. J., *State Grants-in-Aid*, pp. 90–140. Also, Bitterman, *op. cit.*, Chaps. IV, XII, XIII, XIV, XV, XVI, XVIII, XIX.

that the relative importance of realty as a reimbursement base has declined on the state-local level.[11]

This decline may be given tentative quantitative expression by relating the dollar amounts of grants for school purposes to the total combined state and federal grants. In 1925, 254 million dollars out of a total of 454 million dollars (Table 2, cols. 3 and 6; Table 3, col. 3) were made available in the form of school grants. In other words about 56 per cent of total grants was represented by school grants. In 1935, however, school grants approximated only 522 million dollars out of a grand total of 3 billion 403 million dollars. In terms of per cent, the importance of school grants declined from 56 to 15.

It may be observed that this decline in the relative quantitative importance of realty as a reimbursement base was accompanied by complete elimination of this determinant in some states.[12] The decline in the number of states using taxable real property of the grant receiving jurisdictions as an allocation factor coupled with the fact that the reimbursements made coincidentally to the assumption of "new" functions are rarely tied to realty [13] would seem to justify a brief inquiry into the limitations of realty as a reimbursement determinant.

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[11] In this connection it may be observed that state-local public assistance grants which become prominent upon termination of the period covered in the above discussion employ realty as a reimbursement base but to a limited extent. As of 1938 only the following states used realty as a partial reimbursement factor in connection with the administration of assistance programs: Utah, North Carolina, Georgia, Wisconsin, Indiana, and Ohio. Source: Unpublished data, courtesy, Ewan Clague, Director, Bureau of Research and Statistics, Social Security Board, Washington, D. C.

[12] It would appear that in 1936 some 23 states used realty as a reimbursement determinant in connection with the administration of school grants, whereas in 1933 some 27 states had used realty for the purpose under consideration. *Cf.* Bitterman, *op. cit.*, p. 444, and Hinckley, *op. cit.*, p. 90 *et seq.*

[13] *Cf., supra,* p. 16.

Broadly speaking, realty as a reimbursement determinant is apparently pressed into service with a view of assuring uniform service offerings with uniform tax effort [14] on the part of the grant receiving jurisdiction. To accomplish this joint objective in any given case, the following necessary conditions must prevail. In the first place, the service offering must be susceptible of standardization and the standardized offering must be convertible into a dollar equivalent. Second, the grant-awarding jurisdiction must be in a position to control the effective tax effort made by the receiving jurisdiction coincidental to the performance of a given function or set of functions.

It requires no labored argument to show that, usually, one, if not both, of these conditions are not fulfilled by the typical contemporary institutional milieu.

The lack of standardization of such service offerings as are represented by education [15] and welfare services [16] is common knowledge. Similarly, the institutionally given lack of control of awarding jurisdictions over the effective tax effort on the part of receiving jurisdictions is an established statutory fact.

Among these factors, it would seem that the lack of effective control over local tax rates has become an objection of increasing importance. Unless such control can be effectively exercised, reimbursement by means of the conventional types of grants which employ realty as a determinant cannot be expected to assure service offerings which comply with *any* standard that the awarding juris-

[14] For the purpose in hand "tax effort" may be defined as the ratio of "the sum of the grant receiving jurisdiction's tax collections" to "the value of the receiving jurisdiction's tax base."

[15] *Report of the Advisory Committee on Education*, 1938, *passim*.

[16] Blough, R., "Equalization Methods for the Distribution of Federal Relief Funds," *Social Service Review*, IX, 423 ff.

diction chooses to specify. In view of the changes in "the climate of opinion" which have characterized the recent past, any reimbursement base which cannot be relied upon to assure performance of given governmental functions on a designated level is devoid of political appeal. Such determinant is likely to continue to lose ground unless there is considerable change in politically effective sentiment.

While the indicated objections apply without qualification to the realty reimbursement base if the device is used on the state-local level, a further basic objection may be urged against its employment on the federal-local level.[17] This objection, in essence, grows out of the fact that there obtains no constant or near constant relation between the value of real estate and more comprehensive measures of the states' revenue capacities.[18]

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[17] It may be pointed out again that at the present, realty is not used as a federal reimbursement device. However, it may be observed that whenever the use of some model tax system is suggested for federal reimbursement purposes, realty is typically assigned the role of a partial but heavily weighted reimbursement determinant. Newcomer, Mabel, *An Index of the Taxpaying Ability of the States, passim.*

[18] Wueller, P. H., "Income and the Measurement of the Relative Capacities of the States," in National Bureau of Economic Research, *Studies in Income and Wealth,* Vol. III, p. 283 ff.

CHAPTER III

OVER-ALL TAX LIMITATION

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THE collateral effects of the adoption of an over-all limitation on real estate taxes have been as significant as the direct results. Direct results from setting a ceiling on the total amount of taxes levied against a piece of real estate have been reduction in real estate taxes; broadening of the tax base; improved tax collections; and a tendency toward greater interest in real estate investments, especially home ownership.

Among the collateral results have been a more widespread interest in taxation and especially tax procedure; improved financial efficiency in government administration; a restudy of the financial needs of the educational system, resulting in a sounder basic policy for financing schools; and increased scientific study of land economics and the position of real estate in the economic structure. Some, although not all, of these results were foreseen by the National Association of Real Estate Boards when it first suggested over-all limitation of real estate taxes as a part of its program for tax adjustment.

The over-all limitation plan as suggested by the Realtors' Association is part of a program of several changes suggested to readjust the real estate tax structure. It is not the pur-

pose of the Association that over-all limitation should be considered as in itself a complete program, nor as a final solution.

Over-all limitation differs from other types of limitation. By "over-all" is meant a fixed limit or ceiling on the total taxes which may be levied against a single parcel of real estate by all taxing units within a state. For a long period in our history, limits of various kinds on real estate taxes and bond issues based on real estate as security have been known. In 1931 the Real Estate Association suggested that a ceiling be placed on the total amount of taxes and suggested that this ceiling be expressed in a percentage of value.

Purpose of Tax Limitation

Concurrently the Association suggested other steps to be taken. The over-all limitation is intended to be considered with the suggestion that the value of real estate be computed on the basis of its productivity or income. Hence in suggesting an over-all limit of one per cent of *true* value it was intended that true value should be the 100 per cent value computed on the basis of income or productivity. Thus the one per cent limitation would become an amount which the taxpayer himself could definitely ascertain. Also, it would be an amount which could be computed accurately by tax assessing and collecting bodies.

In arriving at the figure of one per cent, the Real Estate Association made a detailed study of the earning power of real estate. It was discovered that over long periods of time, typical parcels of real estate earned an average net income of 3.97 per cent on their value. If, therefore, four per cent be taken as the earning capacity of real estate,

a tax rate of one per cent would be the equivalent of a 25 per cent income tax.

Economists state that real estate in the United States earns approximately one-fifth of the national income. It was felt, therefore, that real estate earning only 20 per cent of the national income should not be asked to continue to pay upwards of 40 per cent of the cost of all government. This line of reasoning made great appeal to taxpayers and to many tax experts and students.

Admittedly, over-all tax limitation was not a complete solution. However, it was felt that it would provide a way of forcing action on real estate tax readjustment and directing this action along channels which would lead ultimately to complete revision of the existing system along basically sound lines and, also, would accomplish immediate needed results.

Results of Tax Limitation

The tax limitation measure has now been adopted in nine states; in some cases by statutory enactment and in others by constitutional amendment.

The direct results have been as follows: (1) Sharp reduction in the amount of taxes levied against real estate. (2) Broadening of the base of taxation so that other forms of wealth are sharing with real estate on a more nearly equitable basis the cost of operating government. (3) Intensive study of tax assessing procedure. (4) Greater governmental economy and efficiency. (5) A wider basis of financial support for educational systems. (6) More efficient budgetary planning, frequently through the establishment of centralized budgetary agencies.

Admittedly, there is much yet to be accomplished even in those states which have progressed furthest along these

lines. It is my belief, however, that greater progress has been made toward real tax justice in those states than has been made in the majority of the others where different approaches have been tried toward the ultimate solution.

These results, of course, have not been accomplished without difficulties and in some cases serious distress. This was foreseen. Real estate taxation is at a crisis. To borrow a surgical term, a major operation is necessary if we are to protect real estate owners against tax confiscation of their properties and if we are to protect our governments from financial bankruptcy because of dwindling real estate tax revenues. A surgical operation is always attended by distress, shock and a more or less long period of convalescence. The analogy holds true for the real estate tax system. I do believe, however, that in those states which have undergone the surgical operation of adopting the over-all limitation principle, the patient has been cured of a basic disease and is well on the road to recovery.

In the state of Washington, for instance, the principle of over-all limitation has been submitted four times at two-year intervals to the entire electorate. Each time it has been re-adopted by overwhelming majorities. After six years of experience with a ceiling on their real estate taxes, the state of Washington in 1938 again adopted this measure. The taxpayers there have now decided that they want the limitation measure written into the basic law of the state—the constitution.

In Washington, as in other states, real estate taxes were sharply reduced by over-all limitation. The basis of taxation has been broadened and the other results noted previously have been achieved.

The state of Ohio was also one of the earliest states to adopt over-all limitation. There have been many confus-

ing reports from Ohio. The opponents of over-all tax limitation have blamed all of Ohio's economic ills on this measure. These opponents have made extravagant statements regarding the effects of limitation on government services and especially schools.

EFFECT OF TAX LIMITATION IN WASHINGTON

	1931	1932	1933	1934	1935	1936
Property Taxes....	$80,016,000	$73,357,000	$66,469,000	$54,019,000	$48,442,000	$42,168,000
Total All Taxes....	$100,220,000	$88,414,000	$82,299,000	$76,636,000	$79,111,000	$79,803,000
Reduction from 1931 Taxes......	....	$11,806,000	$17,921,000	$23,584,000	$21,109,000	$20,417,000

I have personally studied the Ohio situation very carefully and have attempted to analyze the claims made both by the opponents and the proponents of tax limitation. I am firmly convinced that in Ohio the benefits far outweigh the difficulties. The crisis existed in Ohio prior to the enactment of the limitation measure. Enactment of the limitation measure focused attention on the crisis and in my opinion helped materially to meet it.

This opinion of mine is borne out by statements from unimpeachable authorities in Ohio. One such statement comes from a former governor who knows the economic structure of his state from firsthand experience. Myers Y. Cooper, now the chairman of the National Committee on Real Estate Taxation, states definitely:

We stand by our guns as we did when the fight was made for tax limitation of real estate. That there were certain definite advantages which I now restate:

1. A limitation reduces the cost of government.
2. A limitation reduces real estate taxes and shifts part of the cost of government to those who have been escaping their share of the burdens.

3. A limitation results in a sounder financial program, especially for the schools.
4. Limitation lowers tax rates and makes it possible for taxpayers to pay the amount they are assessed, thus decreasing the amount of delinquencies and addition to revenues collected.
5. Limitations increase and stabilize real estate values.
6. Limitations stabilize the credit of taxing districts.

The 10-mill tax limitation reduced the tax on real property the first year after it went into effect in Ohio, approximately $37,500,000.

Under the 10-mill constitutional tax limitations two alternatives were possible to keep government properly functioning. The legislature could enact a replacement tax, and distribute it to the local subdivision losing revenue due to the limitation. The other alternative was the voting of levies outside the limitation.

As to a replacement tax the legislature very promptly enacted a three per cent retail sales tax, which yielded $48,-000,000 the first year, or approximately $11,000,000 beyond the reduction made to real property owners. Thus, you will see this tax was not only a replacement tax, but also provided an additional $11,000,000 for new governmental functions. Regardless of the popularity or unpopularity of the sales tax it does have the effect of making all the people tax conscious, with the feeling they are the direct contributors to organized public service.

I state no new principle when I say that the safe course to pursue and the one that will definitely assure the people that they will have an economical government, is to give public officials only such money to spend as prudent economy dictates.

Ohio's first limitation experience in 1911 came with the adoption of the Smith One Per Cent Law, which provided that existing indebtedness was outside the limitation, and

any increased indebtedness must be voted by the people but restricted to a 15-mill limitation.

Prior to the Smith One Per Cent Law, appraisements were made on a decennial basis and the average was about 45 per cent of the real value as of 1910. Following the adoption of the Smith One Per Cent Law, all property was uniformly taxed at its true value in money. This raised the value of tax duplicates and correspondingly reduced the rate. As a matter of fact, under this law real estate tax duplicates increased from $1,656,000,000 to $4,300,000,000, an increase of 162 per cent. Intangibles increased from $827,000,000 to $2,145,000,000, although invested wealth in intangibles was approximately the same as real property.

The merit of this law was in rate limitation, but it failed signally to make provision to capture and bring into contributory relationship other sources of taxable values that had escaped participation. It can be readily seen that the uniform rule which had been in effect in the Ohio Constitution since 1851, taxing both tangible and intangible property on the same basis, nullified the effect of the law, due to confiscatory and prohibitive rates on intangibles.

The Smith Law was an endeavor to reform the system of taxation and more specifically it was enacted in an effort to correct some weaknesses in the assessment system. While the Smith Law did not accomplish its purpose, it did impress the people of the state with the fact that there is such a thing as tax limitation. After the Smith Law was repealed, the state operated on a statutory limit of 15 mills, which was in effect until 1929, when the people adopted what was then known as the 15-mill constitutional limitation. This amendment repealed the obsolete and archaic uniform rule which had been inserted in the constitution and remained there for a period of 75 years.

With the adoption of this constitutional amendment, the Ohio tax structure was modernized—a constitutional limitation of 15 mills was placed upon real property; the legislature was given authority to tax other forms of wealth at fair and just rates. This method brought to the surface intangible values, much of which had been concealed, thus escaping its just burden of government cost.

But the time finally came for a show-down. The people were aroused and determined to put a stop to the "hit-and-run" methods of taxing real estate on a basis distressing to property owners. The constitutional tax limitation of 10 mills was placed before the voters, freed from statutory weakness that had attended statutory limitations denying the right, in effect, to explore and capture new sources of untaxed values and to tax all forms of wealth on an equitable and just basis.

When the one per cent limitation was adopted, it meant the assumption of certain school liabilities by the state and it was necessary to establish a school foundation to aid the educational system, which has been done.

These are definite, tangible results. The Ohio experiences are paralleled by experiences in the other states. Probably the most significant collateral result is the focusing of public attention on the need for a revision of our entire tax structure. For many years tax students have urged that ability to pay should govern taxation and that all beneficiaries of government should contribute proportionately to the cost of government. The crisis in real estate taxation demands that action be taken so that these theories shall become facts.

For instance, there is a definite movement in the country that all taxation shall be related to income. In Michigan a proposal has been made that the present ad valorem sys-

tem of taxation on real estate and personal property be replaced by a system of taxation on income. A similar proposal is being made in Florida and elsewhere in the country. This basic idea is to be discussed more in detail before the Tax Policy League at a meeting later in the session by Mr. Nelson, executive vice president of the National Association of Real Estate Boards.

The United States is a progressive nation. Unfortunately, however, progress in the field of taxation has not kept pace with progress in other fields. We have not lacked studious leadership in taxation. Our handicap has been in obtaining the adoption of the principles and suggestions thought out for us by economists and especially by those who are expert in the taxation field—our tax commissions, our university professors, and the legion of administrative officials in government.

The greatest effectiveness, therefore, of the tax program of organized real estate interests seems to me to lie in the fact that it forces remedial action from those politicians who heretofore have given only pre-election promises.

CHAPTER IV

OVER-ALL TAX LIMITS IN WEST VIRGINIA

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Causes for the adoption of property tax limits by the people of West Virginia were about the same as those for similar restrictions imposed in other states. As Professor Baldwin summarized the situation, "farm and home owners in the state, restless under the direct tax burden which had steadily grown heavier, despairing of any substantial relief from legislative action based on sound and broad tax principles, uninformed on the tax problem as a whole, and aware only of the particular hardship that was all too obvious, were persuaded that a constitutional amendment providing for classification of property and tax limits upon each class, was the first needed step in a program of tax reform." [1]

Thus, in response to considerable pressure throughout the state, a special session of the legislature met in July, 1932, "with the usual lack of preparation, program or direction—and, incidentally, with a general election only four months away. It worked with a will at every available salary; it chopped at organization and personnel; and it ended by ordering every local authority to restrict its revenues to 85 per cent of the previous year's levies. To make the matter permanent, it collected the remnants of several proposed

[1] Robert D. Baldwin, *The Financing of Public Education in West Virginia*, p. 23.

tax limitation amendments that had been political handballs for several years past, and with scissors and pastepot prepared a new version that passed the legislature by the required two-thirds vote during the closing days of the session. Without serious opposition, it was submitted to the voters in the November election in 1932 and accepted, in so far as it was voted upon at all, by a seven-to-one vote."[2]

This amendment, born in such haphazard fashion, and curious and new invention that it was, attempted to do several things: it classified property into four classes; it placed a maximum rate on each type of property, a rate expressed in one figure for all governments combined; it established a point (50 per cent above the so-called "maximum" levies) beyond which 60 per cent of the qualified voters could not raise the upper limits; and it permitted a graduated income tax.[3]

The Property Tax Under Tax Limits

The most important general aim of the amendment had to do with the property tax, and several lines of betterment were anticipated. One of these, of course, was to reduce the burden borne by property owners, particularly holders of real estate. This was accomplished immediately, for the following maximum rates were written into the constitution: For Class I property, consisting of tangible personal property used in agriculture as well as all intangibles, the rate was set at 50 cents per $100 assessed valuation. For Class II property which included all property owned, used and occupied by the owner for residential

[2] John F. Sly and George A. Shipman, "Tax Limitation in West Virginia," in *Property Tax Limitation Laws,* p. 80. The actual vote was 335,482 for ratification and 43,931 against.

[3] Article X, Section 1.

purposes as well as all farms cultivated by the owner, the rate of $1.00 was fixed. For Class III property consisting of all real and personal property situated *outside* of municipalities exclusive of Classes I and II, the rate was made $1.50; and for Class IV property which included all real and personal property *inside* of municipalities exclusive of Classes I and II, the maximum was $2.00. It is questionable whether many people realized how drastic would be the effect of these reductions on revenues. Before the amendment, the average rate of levy for the state was $2.65 per $100 valuation, but in 1937 the average rate was only $1.52.[4]

A second method of improving the property tax anticipated by advocates of tax limitation legislation, was that real estate would be assessed at full value throughout the state. In 1930, just two years before the amendment was approved, Dr. Roy G. Blakey had completed a comprehensive survey of the tax system of West Virginia at the request of the governor, and had found that for the entire state, all farms compared were assessed at an average of 69.64 per cent of their sale prices; urban lots, improved and unimproved, at 64.39 per cent; and tracts at 61.49 per cent. The average for 1,355 widely selected and perhaps typical cases of all classes of property was found to be 65.22 per cent.[5]

Averages, however, covered up the actual ratios which existed for individual properties, and great inequalities were found in many counties. For example, assessed valuations of real properties when compared with prices received from their sales during the same year were 15 to 254 per cent

[4] Richard E. Hyde, Director of Research, State Department of Education.

[5] Roy G. Blakey, *Report on Taxation in West Virginia,* p. 11.

for Kanawha County (Charleston); 17 to 220 per cent for Ohio County (Wheeling); 48 to 705 per cent for Cabell County (Huntington); 8 to 92 per cent for another county; 10 to 400 per cent for another; and 12 to 295 per cent for another.[6]

These same counties have not been re-examined since the tax limit laws went into effect, but available studies indicate that great inequalities continue to exist. Indeed, it is likely that ratios similar to those mentioned above could now be found in various sections of the state. A recent study [7] of 600 farms in West Virginia indicates that notable differences exist between Farm Credit Administration and county assessors' appraisals of rural properties. In one county the assessed value of 17 farms ranged from 17 to 7 per cent of the appraised normal value, and in another, the ratio varied from 35 to 175 per cent.

In a study [8] of Marion County covering the period from 1927 to 1937, Miss Helen Boggess separated all "normal" sales for the year 1937, which included 149 properties. The average assessment was found to be 73 per cent, although sales in the nine tax districts ranged from 43 to 111 per cent and individual properties were assessed at from 6 to 400 per cent of their sale prices. In an incomplete study [9] of sales for 1939 in Monongalia County, 58 properties were found to be "normal." Of these some were assessed at 4 times their sales price, while others were assessed at one-eighth of their market value.

It is readily seen that tax limit proponents have been disappointed in their hope that real property under the

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[6] *Ibid.*, p. 14.

[7] *Service to Agriculture*, Bulletin 278, Agricultural Experiment Station, Morgantown, 1936, p. 30.

[8] M. A. thesis, West Virginia University, 1939.

[9] By the author.

over-all amendment would be assessed at full value. The assessment of personal property in the state, however, is done even more poorly than formerly. Those favoring restrictions had been particularly solicitous to point out that the new classification with the 50 cent rate for intangibles would drive these forms of property into the open. Considerable data are available to show how woefully inadequate has been the assessment procedure under tax limits for personal property as a whole.

State Tax Commissioner James voiced the unfulfilled hopes of tax limit advocates in this connection when he said recently: "You will recall that the sponsors of the tax limitation amendment . . . had great hopes of the amendment being effective in bringing out of hiding and restoring to the assessment books substantial values in intangible personal property. Candidly, we must admit that those hopes have not been realized."[10] In discussing the poor assessment of all personal property, Mr. James commented that "According to the July issue of the *Federal Reserve Bulletin,* bank deposits alone in West Virginia on January 1, 1937 amounted to $268,524,000. The records of the State Road Commission indicate that approximately 285,000 automotive vehicles were registered in West Virginia on the first day of that taxable year. Those two items alone are almost equal to the entire personal property assessment for 1937."[11]

The percentage that personal property bears to total assessments for 1930 and for 1937 throws added light on the problem. Before the amendment was passed, personal property was 16.9 per cent of all property listed, while in 1937,

[10] Ernest K. James, Address before West Virginia Chamber of Commerce, Feb. 3, 1938, p. 9.
[11] *Ibid.*

after operation of tax limits for several years, the percentage was only 15.7 per cent. Some amusing but worth-while sidelights may be thrown upon the assessment of personal property in West Virginia. Since the entire state has only 55 assessing offices (one for each county), it is possible to make significant comparisons of *average* valuations of certain types of personal property in two jurisdictions. The average per capita assessed value of all intangibles ranged from $20 in one county to $337 in another. Household goods varied from 12 cents per capita to $41 per capita in different counties, on the average. Automobiles ranged in average assessed value from $96 in one jurisdiction to $244 in another. Incidentally, over 50,000 registered automobiles do not appear on the tax rolls at all. A $4 hog in one county would be worth $21 in another, and a $16 cow would increase its value to $46 by crossing a county line.[12]

All told, it might be said that tax limits have failed utterly to improve the assessment of property, real or personal, in West Virginia.[13] There is some agitation at present for a system of greater state supervision of local assessments. The problem is increasingly more acute in view of the fact that the system of state aid has developed competitive undervaluation of property among some of the counties.

Public Services Under Tax Limits

The amendment from its inception has had far-reaching effects upon public services in West Virginia. In its earlier stages, because revenues were reduced sharply and no replacement provisions were made, many essential public

[12] Data from *Biennial Report,* State Tax Commissioner, 1937–38.

[13] The merits of exempting or taxing intangibles are not considered in this paper. Rather, the idea has been to inquire into the arguments of tax limit proponents, and to note the actual results obtained so far.

services had to be discontinued outright, or drastically curtailed. Policemen were dismissed, street lights turned off, and entire court houses and city halls were closed. Library services were either curtailed or suspended in many centers. Schools and roads, being large items of expenditure, were especially hard hit. Public institutions—eleemosynary as well as educational—were hampered by reductions, and their building programs were stopped.

Many of these services have not been replaced or brought back to normal even today. The public school system still is in the throes of tax-limit tangles, and some of the 55 counties are expected to have less than nine-month terms this year, as in the past six years. Under the tax limits it is well-nigh impossible for all the counties to obtain sufficient revenue to have the full school term. Needless to say, many of the school buildings have inadequate equipment for modern instruction, and parent-teacher organizations are called upon to contribute the most elementary equipment. Some of the cities and counties would have defaulted payments of principal and interest on their bonded debts but for the fact that the courts have held that first choice in the use of available revenue must be given these debts. Cities make a practice of levying special charges for certain public services in order to reduce the pressure on tax funds. For instance, Morgantown, a city of about 20,000, charges \$12 a year for garbage and ash removal, or \$14 if paid quarterly.

While part or all costs of some of the functions of local governments have been transferred to the state, such as schools and roads, local jurisdictions are hard hit to discover ways and means for meeting their obligations promptly. The 1932 tax rate ceiling was pitched so low that local boards are unable to anticipate revenues to any

degree of exactness in advance, and this creates considerable uncertainty. The maximum tax rate in practically every jurisdiction has been reached, and when changed conditions in a county cause property assessments to be revised either upward or downward, available funds are changed accordingly. Hence there is a condition of instability among all governmental services dependent upon property taxation.

Local governments, furthermore, frequently have been unable to take advantage of some of the national welfare programs, since they cannot match federal funds, or even set up essential machinery for securing aid. For instance, Morgantown failed to obtain a quarter-million dollar housing project, otherwise approved, because of the outgrowth of circumstances connected with property tax limits.

In this connection, it should be pointed out that the financial situation existing in the municipalities is in direct contrast to the condition of the state treasury. At the end of the last fiscal year (June 30, 1939), the budget director announced there would be a cash balance in the state treasury. At the same time, there was general financial distress among the cities of the state. One commentary presents a picture of this paradox:

> In spite of the reported decline in the state's revenues during the past fiscal year, the budget director recently announced that there would be a cash balance at the end of the current fiscal year. That is a continuation of a good financial record on the part of the state government.
>
> Enthusiasm for the record of economy and expert management of funds should take into account other vital factors that remain among our most pressing problems. The mere fact that there will be a cash balance at the end of the current year is but one, the brighter side, of the picture.
>
> On the other and equally important side, we have county schools operating year after year on below-standard terms. We see some of our county high schools threatened with the loss of their accredited

ratings; others have already been dropped from the association of accredited high schools. Unqualified teachers, inadequate libraries, too heavy pupil-teacher loads and short school terms have been cited as the chief reasons for the losses of ratings. . . .

On this same side of the state's financial picture is the depressed fiscal condition of many of our municipalities. Since the enactment of the county unit system, some cities have been forced to cut their health, fire and police organizations below the minimum requirements. There are but very few governmental services more vital to the welfare of the people than municipal fire, police and health protection. The fact that the state has plenty of money to finance its operations while municipalities are forced to operate on a sub-par scale is a strong indictment of the method by which revenue is distributed.

The state has operated without a deficit for several years. Meanwhile, the financial situation of the cities and of the public schools, two of the greatest and most important governmental services, continue in a below-standard status.[14]

West Virginia's Present Tax System

Using population estimates for 1937, the per capita yield of all state taxes for West Virginia in 1938, was $24.50. This is just 10 cents less than the average for all states in the country, according to Tax Policy League figures.[15] The actual collections for last year exceeded 45 million dollars—just one-tenth that of New York State. Let us examine briefly the present tax system in West Virginia to see if the diversity promised by proponents of tax limit legislation has been forthcoming.

There are, roughly speaking, twenty different sources of revenue for the states, of which West Virginia uses fourteen. Comparing this state's taxes in 1938 and the percentages obtained from each with those of all states combined, some striking facts can be noted. Whereas the gasoline tax provides about one-quarter of the average state's revenue, it provides slightly over 20 per cent for West

[14] Editorial, *The Daily Mail,* Charleston, West Virginia, May 3, 1939.
[15] *Tax Policy,* VI, v.

Virginia. However, sales levies contribute only 14 per cent of the average state's revenue, while West Virginia obtains over 46 per cent of its receipts from this source. Net income taxes are next in line for all states, but West Virginia secures only 4 per cent of its revenue from this source. Parenthetically it might be stated that New York State obtains less than one per cent of its large revenues from sales taxes, and over 38 per cent from income levies. The only other important tax in West Virginia's system is the alcoholic beverage levy (a government monopoly) which yields about 10 per cent of total revenue as compared with nearly 9 per cent for all states.

By no stretch of the imagination can it be said that tax limits have created diversity in West Virginia's tax system. A total of over 46 per cent of the state's revenue coming from regressive sales levies, and only 5 per cent from income and inheritance taxes combined, gives a summary picture of present conditions after seven years of restrictions. *Tax Policy,* in presenting the above figures for 1938, was impelled to make this comment:

> New York led the states with a total tax income of $443,962,930. It also led, however, in a much more important way, for it effectively demonstrated that a state could finance itself without recourse to the consumption-burdening levies which are so popular in a number of states. The state does not levy sales, chain store, soft drink, margarine, or tobacco taxes. Nor does it levy poll and personal property taxes, which although not taxes on consumption, are admittedly regressive. . . . This record may be contrasted with that of West Virginia which has one of the most regressive tax systems in the country.[16]

Only four states, in 1938, collected such a large share of their total revenues from any one tax, and gasoline, not sales, afforded the base in those instances.

[16] *Ibid.,* p. iv.

Conclusion

What the present tax problems of West Virginia would have been without property tax limits, we cannot say, of course. Certain conclusions, however, seem warranted from a review of the state's experience over a period of seven years.

First, tax limits cure few if any of the evils they are expected to remedy. It is true that they force adjustments in the tax system, but in no orderly manner, and the evils they create may be as great as those they alleviate. A continuing staff of well-trained personnel in the state tax department would have been able to devise a plan of action to obtain the benefits secured for property owners in West Virginia by working out a plan of improvement of the tax system as a whole, and would not have subjected many of the essential public services to such severe blows as they have undergone under tax limits, nor have saddled the consumer with the obnoxious burdens engendered by the current sales taxes.

Second, public services were severely crippled by the amendment, and have not regained their former position in some important respects. Despite the imposition of special charges for ordinary services, many local governments are continuously threatened with crises in their finances, and there is a general municipal as well as editorial cry for solution of this problem at the present time.

Third, West Virginia's tax system, after seven years of tax limits, is one of the most regressive in the country. While sales taxes yield nearly half of the state's revenues, income, inheritance or other levies, conforming with the principle of ability to pay, form only a small portion of the revenue system.

Finally, there has developed a widespread feeling apparently, that only parts of the amendment were intended to be enforced. Certainly two major provisions were (1) to limit property tax rates, and (2) to regulate methods by which assessments were to be uniformly made. The first of these has been carefully and rigidly observed in practice. Perhaps there is not a single levying body in West Virginia which has not given complete cooperation to realizing the purpose of the law. However, the second provision is overlooked as often as possible, it would seem. The law says "all property shall be assessed at its true and actual value, that is to say, at the price for which such property would sell if voluntarily offered for sale by the owner thereof." Tax assessors have not taken this provision as literally as other executive officers have the former provision, and furthermore, there has developed an attitude that it is "unholy" or unpatriotic to argue for the same close observance of this provision. As R. B. Marston has pointed out: "If it is a patriotic, and therefore, commendable appeal to seek enforcement of the law that controls rates of levy, is it not equally a patriotic, therefore, an equally commendable, appeal to solicit a like application of the law enacted to control the fixing of property values for tax purposes?" [17]

[17] R. B. Marston, Address before County Assessors, Charleston, December 5, 1939.

CHAPTER V

THE EFFECTS OF TAX LIMITATION IN OHIO

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OHIO local governments have been on tax "rations" for a long time, with intermittent periods of belt tightening, loosening and retightening. As early as 1831 there was a sliding scale of tax limitations for specified purposes in effect in counties and townships.[1] However, before 1911 the rates were so high as to make the practical effects of limitation negligible.

The more modern history of tax limitation may be divided roughly into three periods: from 1911 to 1922, very rigid and low limitation; from 1922 to 1933, flexible and higher limits; and from 1933 to the present, rigid, low limitation again.

Several vital aspects of Ohio limitation must be considered in the subsequent presentation. The limitations in Ohio since 1911 have been aggregate or over-all limits; the levies for debt are included; there is an officially constituted agency for enforcement; and low maximum rates have been established.

TAX LIMITATION FROM 1911 TO 1922

The Smith one per cent law of 1911 gave Ohio "the most rigid as well as the most enforceable tax limit legislation

[1] Act of March 14, 1931. *Acts of a General Nature*, 29th General Assembly, p. 278.

to be found in any commonwealth." [2] It imposed a rigid ten-mill limitation, but permitted the levy of five mills more by popular vote. At the same time a thorough reappraisal act was passed. The joint operation of the two acts was intended to bring out more intangibles, with the incentive of the lower rate. Assessments had been at 30 per cent.

Though a tremendous increase was made in the grand duplicate of the state, the reappraisal failed to put on the duplicate the intangible property owned in the state. "The rate of taxation provided by the Smith law was still confiscatory as applied to intangible property, and yet even as applied to the new grand duplicate was insufficient to meet the expenses of government." [3]

Further, the two laws failed to force maintenance of a high standard of assessment.

> Though property values increased greatly during the period, few counties raised their assessments prior to 1920, and most counties were not reappraised between 1911 and 1926. In spite of the dire need for increased revenues, popularly elected county assessing officers simply would not reappraise real estate and no state or local authority had the temerity to require such action. As a means of insuring a high level of assessments, the tax limit law was totally unsuccessful.[4]

During this decade school and other local debts mounted alarmingly, despite the advantage of voted school levies. Though there was a limit on taxes, there was none on expenditures and borrowing. Operating deficiencies were met by notes and bonds. Improvements, formerly met from operating funds, were financed from borrowings. "Including street repair bonds and the like, Ohio local governments

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[2] Raymond C. Atkinson, *The Effects of Tax Limitation Upon Local Finances in Ohio, 1911 to 1922*, p. 9.

[3] Joint Legislative Committee on Economy and Taxation, *Report*, December, 1926, p. 31.

[4] Raymond C. Atkinson, "Stringent Tax Limitation and its Effects in Ohio," in *Property Tax Limitation Laws*, p. 68.

probably issued more than $50,000,000 of bonds for financing current expenses before the Smith law limitations were finally relaxed.[5]

In addition to the more normal borrowing methods, there was a failure to meet sinking fund obligations and there were diversions of bond funds and sinking funds to operation. The total debt in this period jumped from 188 to 510 million dollars. The total cost to later taxpayers of deficiency bonding, refunding and failure to maintain sinking funds is estimated at 100 million dollars by Atkinson.

Nevertheless, the tax limitation did reduce the average over-all tax rates. The average from 1906 to 1910 was 34.56 mills and the average from 1910 to 1920 was but 14.85 mills. However, during the decade the rates mounted annually from a low in 1911 to two-thirds of the former level in 1920.

The pinch of low rates was shown by deficits in most of the larger cities prior to 1915. The rising price level thereafter merely accentuated the problem. Further recognition of inadequacy of income was shown in compulsory county and state school levies, effective in 1920. Mr. Atkinson, in his monograph on this period, concludes that such limitations fail to take into account the variations in the taxable wealth of different communities and frequently disregard variations in the financial requirements of different types of communities.

Tax Limitations From 1922 to 1933

In the second modern period major modifications in the Smith one per cent law took place. Permission was given cities and school districts to levy outside the 15 mills with

[5] *Ibid.*, p. 69.

popular approval. Other acts made the limitation substantially a 15-mill limitation upon unvoted levies.

With the undesirable results of rigid tax limitations before it, the legislature turned its attention to more sound and permanent types of control. In 1921 an act was passed limiting the total amount of outstanding bonds, forbidding the issuance of bonds for current expenses, limiting the terms of bonds to the probable life of improvements, requiring the issuance of serial bonds to prevent abuse of sinking funds, and providing shorter maximum maturities for bonds issued for different classes of improvements.

Since many counties had not reappraised property between 1910 and 1925, the legislature passed an act providing for a sexennial appraisal. The Tallentire act gave an opportunity for city "home rule" in taxation by permitting cities to enact charter limit provisions exempt from statutory limits. Cincinnati and Akron have enacted charter limitations. A further act tightening the reins on debt provided that no bonds could be submitted to a vote unless there was also submitted a levy for retirement and that a 55 per cent majority be necessary on such vote.

In 1925 the Vory's mandatory budget law sought to prevent expenditures in excess of reasonably anticipated revenues, the payment of obligations in subsequent years, the appropriation of more money than was in sight, and spending in excess of appropriations. The calendar year was established as the uniform fiscal year. The county budget commission was vested with the duty of certifying the amount of revenues which could be reasonably anticipated.

Oddly enough, the county governments were caught short by this program and special legislation had to be passed to permit a funding of current indebtedness. Counties, gen-

erally, have been in a favored position because the county budget commission is made up of the county auditor, county treasurer and county prosecuting attorney. Schools and cities have no representation on the commission under a decision of the Supreme Court, which is no longer tenable.[6]

It was concluded in 1926 that substantial progress had been made in remedying the taxation ills and financial practices which threatened the continued operation of a great many local governments. The use of public credit had been placed on a sounder basis, the inflexibility of the rate limitation system had been relaxed with substantial safeguards retained, the development of sound budgetary procedure had been fostered, and the confusion of tax and bond limitation measures needed codification.[7]

As a general rule, from 1925 until the depression, local budgets were kept in balance primarily through the medium of voted levies, especially for schools. By 1930 three-fourths of the school districts of the state were relying upon voted levies for some of their operating expenses.[8] The success of the schools in the public forum permitted the paring of their inside limitation levies for the benefit of other local units.

Atkinson summarizes the effects of limitation in this period as the balancing of local budgets until the depression, the raising of property tax revenues in the principal cities to approximately the level in other states, the disproportionate share of local revenues which the schools secured, and the instability of voted levies.[9]

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[6] *State* v. *Groom*, 91 OS 1 (1915).
[7] Joint Legislative Committee, *op. cit.*, p. 37.
[8] Atkinson, *loc. cit.*, p. 70.
[9] *Ibid.*, pp. 70–71.

Tax Limitation Since 1933

In 1929 the Ohio constitutional uniform rule was abolished to make way for a classified property tax. A concomitant was an amendment providing for a 15-mill limitation, demanded by the real estate owners and especially the farmers. Though the amendment itself merely "froze" the statutory limits, it led to more serious results. In the throes of the depression in 1933 city real estate boards, taxpayers' associations and farmers joined to force a constitutional 10-mill limitation by a 3 to 2 vote.[10] An interesting sidelight of this election was the adoption of an old-age pension system in the state.

In placing the constitutional limit in effect the School Foundation program "pegged" the levies for the taxing districts at two-thirds of the average rate for the five previous years. Since debt charges could not be materially adjusted and constituted a prior lien on tax funds, the pinch of the limitation was upon funds for current operation. Without replacement taxes Toledo would have had $17,000 for current operation in 1935, the county could have operated for five weeks and the schools for about a month.[11] Other Ohio communities showed the same drastic effects of the limitation.[12]

The total net indebtedness in the local governments has shown a considerable decline since 1930. It is interesting to note that there has been no appreciable reduction of the general bonded indebtedness in cities in this period. This

[10] Article XII, Section 2.
[11] H. T. Shenefield, in *Property Tax Limitation Laws,* p. 72.
[12] Arch D. Shultz, *The Fiscal Situation in Ohio,* pp. 57–64.
S. J. Barrick, "Ohio Learns a Second Lesson," *National Municipal Review,* XXIV, 616–620.

latter proposition is the result of new capital financing under federal programs and refunding operations.

Comparative Ohio Local Government Debt
(In Millions)

Year	Cities	Schools	Counties	Total[a]
1900	78	7	11	96
1910	150	17	27	188
1920	289	100	77	510
1930	483	239	170	977
1937	394	173	111	741
1938	398	175	105	716

[a] Note: Village and township debts not tabulated; these debts in 1938 were $37,052,000 and $850,000, respectively. *Source:* Auditor of State, *Annual Report*, 1938, pp. 375 ff.

A combination of a new appraisal under the classified property tax, the tax limitation and the depression has since 1930 caused tax collections from direct property taxes to drop almost half, and the total tax duplicate to drop one third. Tax delinquencies in the state reached $182,000,000 in 1938, and 8.8 per cent of the 1937 duplicate was reported delinquent.[13]

The annual surveys of cities over 30,000 population[14] disclose no city of Ohio with a tax rate of less than 40 per cent more than the limitation. A study of the Lucas County treasurer's notice of 1939 tax rates discloses that none of the 41 taxing districts have rates of 10 mills or less; seven rural townships have over-all rates under 11 mills; 18 districts have rates over 15 mills; and five districts, of which Toledo is not one, have rates of 20 mills or more. Thus, it

[13] Auditor of State, *Annual Report,* 1938, p. 361 ff.
[14] Rosina Mohaupt, "Tax Rates for Cities," *National Municipal Review,* December issues.

may be concluded that the limitation has again failed to bring rates to the level set forth.

That the limitation has still failed to bring valuations to true market values is shown by Miss Mohaupt's study. Valuations in these major communities were estimated as low as 50 per cent in 1938 and 60 per cent in 1939; few of the cities claimed 100 per cent valuation.

Trend Toward Indirect Taxes

The trend toward indirect taxes in Ohio shows an acceleration coincidental with the limitation. The table below presents the more recent trends of tax collections, as classified by the Auditor of State.

TOTAL TAX COLLECTIONS IN OHIO

(In Millions)

Year	Direct	Indirect	Total
1926	285	45	329
1927	299	48	347
1928	321	63	384
1929	323	73	396
1930	329	78	407
1931	311	82	393
1932	231	79	310
1933	191	80	271
1934	203	96	299
1935	187	153	340
1936	193	183	376
1937	189	190	379
1938	188	171	359

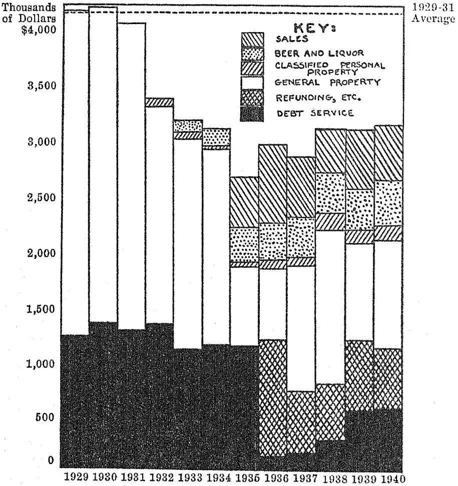
Source: Auditor of State, *Analysis*, showing trends of taxation of state and county tax collections for the periods of 1926 to 1938 inclusive. May 12, 1939.

The burden of direct taxes has dropped from 67.9 per cent in 1934 to 52.4 per cent in 1938. The chief increase in indirect taxes is noted in 1935 and 1936, at which time a general sales tax of three per cent and a use tax were put in effect. The sales tax has not replaced the loss in direct taxes, has until more recently fluctuated considerably in

yield and is generally recognized as not shifting the incidence of taxation from the average home-owning group. By popular vote the sales tax on food has been lifted, and the Supreme Court has since defined candies and confections as exempt food. The inadequacy of the sales tax as a replacement tax is demonstrated in a chart from the Toledo budget.

CITY OF TOLEDO

INDICATION OF FAILURE OF SUBSTITUTE TAXES TO RECOUP LOSS FROM CHANGE OF 15-MILL LIMITATION TO 10 MILLS AND REDUCTION IN GENERAL PERSONAL VALUATION. BASED ON 100% TAX COLLECTIONS AND ACTUAL COLLECTION OF SUBSTITUTES.



Source: *Toledo General Budget*, 1940, Appendix, p. 6.

Trends in Local Finance

A trend toward a more equitable form of taxation is found in the enactment of an "undivided intangible tax," effective in 1934. This tax in 1938 produced but 1.8 per cent of the total tax collection, but is nevertheless generally recognized as a preliminary to a system of income taxation.

Another trend in Ohio local finance is toward the increased distribution to local units of state-collected taxes. A tabulation of such taxes in 1938 shows that about 71 per cent of a collection of $140,000,000 was so distributed.[15]

That the more recent reduction of the tax limit has not been solely responsible for the reduction in the level of local government expenditures is demonstrated from the table below.

EXPENDITURES—110 CITIES

Exclusive of Public Service Enterprises

(In Thousands)

1931	$131,831
1932	111,910
1933	101,884
1934	89,209
1935	89,668
1936	101,512
1937	104,617
1938	117,133

Source: Auditor of State, *Comparative Statistics, Cities of Ohio*, annual.

It will be noted that there was a considerable drop in expenditures prior to the effective date of the limitation in 1935. Since 1935 there has been a steady increase in the annual expenditure.

A study of strictly local revenue sources shows an increase in the so-called nuisance taxes. An upswing is shown

[15] Carlton S. Dargusch and John N. Hart, "Ohio Tends Her Tax-Limited Localities," *National Municipal Review*, XXVII, 519.

in the items of fees, charges for services and minor sales, licenses and permits, fines and forfeitures, and the miscellaneous classification.

Some of the operating expedients found necessary in the fourth decade of this century would properly be a subject for a treatise on how cities should not be operated. Probably the most drastic of the operating expedients was the closing of the public schools in Cincinnati in 1937, in Dayton in 1938 and in Toledo in 1939, among others; and the relief shut-downs in Cleveland and Toledo in 1939.

Debt Policies

Refunding in Ohio local governments has occurred on a wide scale in the last four years. Among the cities which have refunded are Cleveland, Toledo, Akron, Dayton, Youngstown and Hamilton. Though admittedly a poor means of operation there is some justification for the refunding program within the existing tax limitations. Part of this justification is the ability to reduce interest charges on bonds at the low present rates. Cincinnati has done a good deal of refinancing for this purpose. Another phase of justification is that the Griswold Act of 1921 caused a pyramiding of maturities, which are being partially scaled off by refunding. The maturities schedules in the major Ohio cities show rapid declines after the early years of 1940. The alternative to refunding in Toledo in 1940 is set forth by City Manager Schoonmaker as the layoff of 10 policemen, closing 8 fire stations, the layoff of 6 of the 24 garbage collection crews, and the elimination of vital municipal functions in some instances.[16]

Refunding in Ohio has been permitted under a special act,

[16] *Toledo Blade,* January 1, 1940, p. 1.

which expires at the end of the current year, and has been approved by the Supreme Court in at least two cases. It must be done with the approval of the State Bureau of Inspection and Supervision of Public Offices, however.

Scrip has been issued by Cleveland, Toledo, Akron and Youngstown in an effort to bolster depleted operating funds. Most issues came before the tax limitation, and some of the obligations incurred are still outstanding as funded debt. In Toledo redemption was made, for a time, from the solvent waterworks until stopped by a permanent injunction.

Defaults in debt payments occurred in Toledo in 1933 and 1934, in Cleveland for a short period, in Akron from 1932 to 1935, and in Youngstown for eight months. In Toledo a sort of "shotgun" refunding program was accomplished through an illegal bondholders agreement permitting the diversion of debt payments to operating funds. This occurred in Toledo during a period when operating income had dropped from a 1928-1930 level of over four million dollars to slightly more than one and one-half million.

Deficiency bonds, funding operating insufficiencies, were issued in Cleveland, Toledo, Akron, Youngstown and Springfield. These bonds now require the approval of the state tax commission.

Another expedient has been the omission of part of the inside limitation debt levy. This method has served Cleveland, Toledo, Akron, Dayton, and Hamilton. Debt requirements are then met from earnings or, more frequently, from unexpended balances of bond funds. The method supplants, in part, a former method of withholding entirely the payments to the sinking fund commission. The latter practice was halted by an act requiring the county treasurer

to pay over directly to the sinking fund commission the debt levy, without passing through the treasury.

Other Expedients

Another highly unpredictable expedient is the voting of levies. Variable requirements of statutes call for majorities ranging to 65 per cent, with temporary relaxations in majorities. Aside from public school levies, Cleveland has been the most fortunate of the cities. In this city annual levies have been approved since 1933, ranging from one to 7.4 mills. Some few cities have voted pension and fire levies which relieve the operating fund.[17]

Some deception has been practiced by cities on their citizens by the creation of special funds, in order to be able to claim general fund balances. This is especially true in regard to poor relief. Not all the blame can be placed upon the communities, since the state dumped the relief load back upon the cities early in 1937 with inadequate provision for carrying the load.[18]

Other expedients have been permitted with state sanction in recent crises, such as borrowing against delinquent taxes, transfer of waterworks funds to poor relief, and permission to use some state collected taxes formerly pledged for highway purposes to aid in financing police traffic work.

Two of the larger cities, Cincinnati and Columbus, have most often avoided expedients. Cincinnati has for some time operated under an exempt charter limitation of 6.65 mills, has had the advantage of two voted levies, and the voting of inside limitation bonds outside the limit several

[17] Note: Appreciation must be extended Dr. Frederick L. Bird, Director of Municipal Research, Dun & Bradstreet, for material making much of the operating information available for recent years.

[18] Donovan F. Emch, "Toledo, Taxes, and Relief," *National Municipal Review*, XXIX, 6–13.

years ago and now requires but 7/10 of a mill for debt purposes inside the limitation. Columbus has had an income from a light plant equivalent to almost two mills. Both cities are economically more stable than Cleveland, Toledo, Akron or Dayton, which are industrial centers affected materially by fluctuations in the market for convenience level commodities.

Principal proposals for alleviating tax-limited localities include income taxation, permission for cities to levy productive excise taxes, and to place inside debt limitations outside the limitation by popular vote. The first two require state action which has not developed so far, and the third holds no bright possibilities for the immediate future. The mortality rate of the hundreds of levies recently submitted to the people is very high. Former City Manager John N. Edy left Toledo with the comment that one of the city's greatest faults was its negative attitude.

The third proposal would leave with the local communities the problem of working out their own problems. The author would exclude the relief problem from the scope of purely local problems.

Local governments in Ohio today are but humble mendicants daily seeking succor at the hands of the state. Local government in Ohio is rapidly approaching the condition of Germany's local communities—being areas solely for local administration.

CHAPTER VI

THE FLORIDA MOVEMENT TO ABOLISH THE PROPERTY TAX

WALTER P. FULLER

Fuller's Florida Letter, St. Petersburg

STEADILY for the last twenty years Florida has moved to destroy the ad valorem property tax. A bare recital of the facts, however, has little meaning or interest without a certain amount of background and analysis.

Florida is a state of mind rather than a state of political sovereignty. It has been the mecca of more dreams and the cause of more nightmares than any other state save California. It is mercurial. It is temperamental. It is emotional. Every twenty years or so since 1767 a boom has swept over it for reasons too complicated to detail here. But its political setup is such that its economic and business life has been more than is usual divorced from its political life. It has happened that political power has always been lodged in the North Florida farm regions, farm regions fashioned and dominated by the feudal traditions of the Old South, while most business growth has occurred in South Florida. So we see political North Florida dominated by Florida Cracker southerners and South Florida by northern business men.

The result is that new political ideas have made, as a rule, small impression. North Florida has been busy being comfortable; South Florida busy getting rich. Florida has been

politically conservative, economically crazy, since the first Florida boom swept over its lakes and flatwoods from conservative England, before even the American Revolution. At that early period people were going to get rich in Florida producing indigo, sugar cane and turpentine. In the last boom (in addition to lots) it was to be citrus, bananas and sugar cane. Always the booms revolved around land.

History of Homestead Exemption

That homestead exemption should find one of its pioneer and most extreme expressions in Florida is therefore a queer and interesting story. Prior to that there was many a gesture in the direction of property tax abolition. But homestead exemption was the first bold step.

In order to understand this let us elaborate a little on the background.

First it must be understood that let a solid, sensible northern business man arrive in Florida, the first thing he does is shuck his conservative sensible mold and go slightly haywire. He plays around in the sun, lies on the beach, goes fishing, gambles a little, flirts a little, and the first thing one knows he is full of young and exuberant ideas. Hence the 1925 boom with its Grecian pools, its towers and minarets, its master subdivisions, its mammoth groves—and one of the nation's great economic collapses.

I have lived all my life in Florida—part of that time as a real estate developer. I have sold thousands of lots. I am used to all the stock excuses, "I'll see you tomorrow" and so forth. Further, I have heard scores of times, "I must return home and arrange my affairs before I buy this lot." But never *once* have I closed a deal when the client (or victim) went home to "arrange his affairs." Back in his

familiar office he returned to sanity. Which gets us back right where we started, that Florida is a state of mind.

Only twice in the history of Florida has it been swept by an emotional wave that translated itself into major political action. Initiative, referendum and recall, free coinage of silver, all the scores of governmental hysterical urges that resulted elsewhere in legislation, left it cold and untouched.

The first such organized tidal wave that swept Florida was the Civil War. When that clash between economics on one hand and political ideals and social ideas on the other ended in Southern collapse the then Governor of Florida committed suicide rather than accept the inevitable. And the basis of that fanaticism was that it interfered with the ownership of land. Homestead exemption was a result of the second emotional upsurge. And it had its roots in the same emotion: the ownership of land. The 1925 boom started with a state almost debt free. The State Constitution prohibited state debt. This was because of the reaction from the fears and abuses of the post-Civil War carpetbagger days. The simple agricultural communities had total debts in 1920 of $50,000,000 and oxcart forms of government and taxation. The receding tides of this boom left a bonded debt of $550,000,000, mostly bearing 6 per cent and about half maturing in ten years, as a result of trying to streamline a Utopia over night—but with the same old simple oxcart tax machinery. Of course, that machinery broke down. Paradoxically this first step, homestead exemption, which was to free homes, but more firmly fastened the clutch of the bondholder on them, as the amendment eliminated all taxes save for debt service. And then the representatives of those $550,000,000 of 6 per cent bonds stepped in. Levies went up and collections came down. Collections dropped from an average of over 95 per cent in

1925 and 1926 to 79.72 per cent in 1930 and to 52.33 per cent in 1933. Mandamus levies reached in one case a fantastic 3,825 mills, in another 4,260 mills. Two and three hundred mill levies were a commonplace. With delinquent taxes bearing 25 per cent interest the first year, 10 per cent the second year and 8 per cent thereafter, and with the threat of tax deeds hanging over half the property in the state, taxes for the first time in the history of Florida became a serious and ever present reality.

But the seeds that blossomed into homestead exemption and appear ripening into total abolition had been deep planted some time before. First came widow's exemption, with a constitutional amendment to exempt the first $500 of realty values on the homes of widows. The World War naturally added a similar exemption for wounded soldiers. Also exempted was personal household property up to $1,000 which practically eliminated this class of property from tax rolls.

Then the drift of revenue sources from minor political units to major units hit the automobile. At first the state levied no tag tax. Some cities did, some counties also. None enforced the law very vigorously. Then the state tacked on a small tag tax. As the pressure for roads mounted so did the size of the tag tax. Cities and counties dropped out. The tax got so high evasion set in. People quit paying the personal property tax on their autos. To check this the state passed a law requiring owners to produce a personal property tax receipt before a tag would be issued. The resulting rebellion was reflected in a constitutional amendment abolishing the personal property tax on autos. And that wiped out another big sector. To summarize the picture, total state personal property assessed values in 1920 totaled $104,664,992 and in 1937, $50,351,-

837, this in a period during which actual personal property value totals increased easily 100 per cent. Nor do county officials make the slightest effort, except sporadically when prodded by state officials, to value personal property or to collect the tax. The result is that whereas realty ad valorem collections have now returned to between 85 per cent and 90 per cent, personal property collections are less than 50 per cent.

Another constitutional amendment exempted for 15 years the plants of new industrial and manufacturing enterprises. The legislature passed a law exempting almost without restraint the properties of church, lodge, non-profit organizations, private schools and kindred organizations, even though owned mainly for income purposes and not directly connected with the purposes of the institution. Taking the broad hint, the courts decided that even private schools need pay no tax, and at last in the Tampa Mirasol Hotel case declared income the major factor in determining the reasonableness or unreasonableness of an ad valorem levy.

1929 Tax Foreclosure Law

The climactic act of the drama which resulted in homestead exemption started with the 1929 tax foreclosure law. It was drastic and deadly. Before that a tax certificate and the resulting tax deed were merely a cloud on the title. But the 1929 law passed by bond interests soon put the house owner in the street, the tax shark in possession. And that brought sharp reaction. In the 1931 legislature and each two years thereafter, more and more sweeping laws were enacted. These climaxed in 1937 with the famous Murphy Law which allowed an owner to "buy" at phoney "auctions" his delinquent taxes at $1 a certificate plus

minor costs. For the sum of $28 I cancelled $5,800 of taxes on a large business block which originally cost $125,000. Under that law an estimated $32,000,000 of some $75,000,000 of delinquent state and county taxes were cancelled. But so low has fallen the taxpaying morale that some 300,000 properties reverted to the state because the owners would not settle at even that nominal basis. It is true, of course, that in myriad instances the properties are so encumbered with city taxes and liens and with mortgages and title tangles that even with state and county taxes cancelled the property is still completely submerged and bankrupt.

So that homestead exemption by constitutional amendment submitted by the 1935 legislature and adopted by a 3 to 1 vote came as a logical climax to all this economic shift. Because we must all recognize the economic and social revolution that is back of all this monkey business—but I will take up that thread in this tangled skein a little later.

Assessments and Tax Levies in Florida

The next angle of the picture is assessment and tax levy. A tax statement from a Florida county tax collector is a fearful document. First there is the state levy. Then the county-wide levy, school operations levy, school debt service levy, special road maintenance levy, special road debt service levy, and one or more of a score of various other types of special tax district levies. I once found, in the course of a tax and debt survey of a drainage district, a piece of property that had against it levies from thirteen separate political taxing units, all on one tax statement.

Because the state levy is based on county valuations there

has been a race between each of the 67 county assessors to lower county assessed values so as to cut down his county's contribution to state support. The result is that total assessed values for the entire state are but $428,573,992 currently, whereas there is in excess of $2,000,000,000 of fire insurance in effect. In 1926 the total was $623,545,914 in spite of some $400,000,000 of new construction in the meantime.

The result of this low assessment practice is that practically every residence in Florida is now exempt from all taxes save for debt service. In Pinellas County, for instance, with 75,000 people (mostly moderately well-to-do northerners) and with several thousand residences costing well above the $5,000 homestead exemption figure of the Florida law, only 12 homes are assessed at more than $5,000.

But bringing even greater disrespect to the property tax in the public mind is the inequality in assessments, a situation due to the fact that county tax assessors in Florida are purely political and today not over half a dozen of the 67 in the state seriously pretend to modern scientific training as assessors. I recently made a tax assessment study covering 25 counties in connection with litigation between the state comptroller involving some four million dollars of delinquent property taxes. In the 25 counties the ratio of average assessments to actual market value varied among the counties from 12.52 per cent to 60.76 per cent. As among individual properties in a county the swing is even wider. In one county one property was assessed for 5 per cent actual sales price, another at 200 per cent of its sales price—both normal market sales between the well known non-compelled buyer and seller.

Campaign to Abolish Ad Valorem Tax

As evidence of the strength of the desire to destroy the ad valorem realty tax, and as a result of a four-year propaganda campaign by strong interests to capitalize to their advantage on the obvious trend, the principal fight and climax of the 1939 legislature was a proposed constitutional amendment to abolish entirely the ad valorem system and substitute a tax based on income or use value. It was defeated in the lower house by only seven votes. As further evidence of the widespread desire to destroy the property tax rather than streamline it, the same legislature summarily killed a bill to create a state tax commission—Florida being one of three states in the union not having one.

In at least one deliberate effort to bring some semblance of order to this chaos, the last legislature submitted to the people a constitutional amendment eliminating state ad valorem levies entirely. The amendment will be adopted, of course, because Florida, crazy as it is, doesn't shoot Santa Claus. This will remove the low assessment urge and confine the property tax to local political units.

Conclusions

There are several inescapable conclusions. Homestead exemption is in Florida to stay—with just one "if." Debt service payments account for 77 per cent of all local ad valorem taxes. Most political units have borrowed up to or beyond all reasonable limits. For twelve years the state has grown enormously in spite of its own collapse followed immediately by a national recession without precedent for duration and severity. But capital replacements, and extensions, have been impossible from local borrowings. Federal alphabetic agencies have for the time being saved the

situation. But they are in process of curtailment. Homesteads are exempt from taxation for debt service on new bonds. If the growing fashion and popularity of revenue certificate financing does not again save the day, soon Floridians will realize that their only major security for new borrowings is the property now exempt, and it may even dawn on a majority of them that the principal beneficiaries of most public spendings are the homes now exempt from paying for those benefits under the homestead exemption amendment.

There was a day when ownership of land was a man's badge of independence, respectability and wealth. That day has passed. Too universally is land anything more than deep trouble and financial slavery. There is truly a flight from the land. And blindly, gropingly, on waves of emotion rather than with the advice of trained experts, the people are, through their lawmakers, going to remove the load of ad valorem taxes from their land. This is particularly strong in Florida where only 5 per cent of the land is in use.

But in Florida that course is going to be delayed, distorted, and abused because political power lies in an agricultural land where ad valorem taxes rest lightly and because the courts will continue to protect the owners of a half billion dollars of bonds in their vested rights of contract to tax unlimitedly the lands pledged to their debts.

The second is this. The great mass of American people, vaguely and perhaps unconsciously alarmed at the rising tide of governmental cost, the multiplication of governmental functions, without rime, reason or analysis, has arrived at this elemental determination: "from this great flood we will save and make inviolate our homes." Hence homestead exemption in Florida. And you can't argue or

quarrel with that conclusion. It doesn't make economic, or financial, sense. But it proves conclusively, at least to me, that the fundamental of a democracy—a home—is still the fundamental of the people of the United States of America. And from that I take great hope.

While I believe that political laws cannot abrogate or halt the workings of economic laws, nevertheless, increasingly, political philosophy, not economic philosophy, will rule this country.

And while you can't in your secret heart deny a fact that you know to be so, at least you can accept and get along with it in your outward life.

PART TWO

CLASSIFIED PROPERTY TAXES

CHAPTER VII

SOME OBSERVATIONS CONCERNING THE CLASSIFIED PROPERTY TAX

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THE classified property tax developed as one of the important movements for the reformation, or the modification, of the general property tax.[1] The essence of classification is the differentiation in the effective rates of taxation applied to various classes of property.[2] It stands in sharp contrast to the general property tax which attempted to tax all property at a uniform effective rate. This differentiation in effective rates under classification may be the result of law, of administrative action, or it may unintentionally or indirectly result from the operation of law, or the action of public officials. The differentiation may be sanctioned by constitutional provisions or court decisions; it may be extra-legal, if not absolutely contrary to law, as instances of illegal classification are not unknown.

METHODS OF SECURING RATE DIFFERENTIALS

The rate differentials so necessary to classification may be secured through outright variations in tax rates, through the use of fractional assessments for different classes of

[1] The early differential property taxes are not here considered.
[2] For a more complete statement, *see* Simeon E. Leland, *The Classified Property Tax*.

property, through fixed assessments made without reference to values but which produce variations in effective rates, through the use of different methods of valuing property for taxation which because of peculiarities in the valuation formulae produce rate differentiations; or, classification may be brought about by the use of varying exemptions applied to different classes of property. Various combinations of these practices may also bring about classified tax rates. Perhaps in other ways rate differentiations may also be produced. It is important, however, that the variations in rates be uniform as to classes of property and large enough to be significant. Errors of judgment, faulty assessment, mistakes of law, accidents in administration and other unintended events can hardly be construed as instances of classification. If, however, such practices should become recurrent and the differential burdens thus effected could be considered substantial, classification might result. Such instances are generally unimportant.

Legal classification, through statutes or constitutional change, has made little progress during the last ten years. Administrative classification seems to have made more rapid advances, but this may be illusory. As more is learned about administrative practices and the operative results of the property tax, particularly about the practices of assessment officers, differentiations in effective rates through variations in valuation practices tend to become more manifest. It may be that they are no more numerous than before, we may only have a little more knowledge of them, and we know precious little at best. If a study were made of the work of assessment officers, there is reason to believe that fairly comprehensive schemes of assessing property at differential rates would be found. These differentiations occur not only among classes of personalty but

also among different types of real estate. It is notorious, for example, that many assessors value stores and office buildings at higher rates than the homes which voters are supposed to own. Whether these practices are more widespread than heretofore may be doubted—whether they occur less frequently is also to be doubted.

It appears, too, that classification by way of exemption has changed little; there has been some increase, it seems, but not much. About the same states seem to be granting partial or limited exemptions for the purpose of subsidizing favored activities as heretofore. Homestead exemptions have been adopted here and there but these represent extensions of policy for the most part, rather than the adoption of new policies. On the whole, however, the classification movement seems to have made little progress during the last ten years.

How extensive differentiations between the objects of taxation must become to constitute "a class of property" is difficult to determine. "A class of property" is hardly any set of objects a legislative assembly seeks to label as such. Nor is it the familiar groupings local assessors adopt in making appraisals. Dwellings of one story or homes of two stories are not different classes of property in the sense in which classification is intended to apply. Nor does it appear that money in the pocket and money in the bank are generically different; nor that dividend-paying investments are unlike those yielding current returns. The market values may not be identical; the ease of assessment and the effectiveness of enforcing tax liens may differ, but in no significant sense are they different classes of property. What is meant by a class of property is that the things owned are *economically* different; that they are not substitutes the one for the other. This is what the courts seem to have in

mind when they say that the classifications adopted by the legislative assemblies must be "reasonable." Within specific classes of property uniformity of treatment is supposed to prevail—otherwise erratic assessments and discriminations between persons might be confused with classification.

The aim of classification is to treat different classes of property differently—if differentiation is desired—but to treat identically property in the same category. Nevertheless some highly artificial groupings are made. Some properties are distinguished for taxation which really belong to the same economic class. The effect of taxing only a part of the supply of a given thing, or of taxing differently two things belonging to the same economic class is quite unequal. The economic consequences of such policies may be injurious; at least they are of questionable advantage. Yet the practice of dividing things into groups may be based simply on calling things different names rather than finding significant differences in economic characteristics sufficient to justify differentiations in the effective rates of taxation. This criticism can be directed particularly at many of the groups set up under the comprehensive classification schemes found in a few of the states. This is not a criticism of classification per se, but a criticism of the way in which the principle is applied. It indicates a defect, to be sure, in certain tax plans and policies where things that are not economically different are treated as though they were unlike. In such cases, the particular categories for taxation can be criticized, and the rate differentiations applied to them, whatever they are, should be noted. In such cases, classification will consist in whatever legislators and public officials care to make it—until restrained by their own notions or those of the courts, or by the reversal of legislative policy.

The forms or varieties of classified property taxes are numerous. They include low-rate taxes on intangibles, mortgage recording taxes, preferential taxes on bank deposits, taxes on bank shares, bushel taxes on grain, tonnage taxes on ships, ad valorem taxes on mineral production, forest taxes, special treatment of land and buildings, the exemption of improvements, homestead exemptions, the partial substitution of service charges for property taxes, and many others. In short, all cases of property taxation, of whatever type, involving differentiations in effective rates are included. Whether differential rates exist is a fact to be determined, often only by careful research. But classification is as extensive as the rate differentiation. Whether the differentiations are wise is also a subject for research. So great is the variety of taxes embraced under the folds of classification that it is impossible to summarize the research findings or the operative results in all of these fields. A few sporadic examples must therefore suffice.

Classification of Intangibles

It has frequently been said that the success or failure of classification depends largely upon the degree to which it solves the problem of taxing intangibles. As a matter of fact many individuals think the essence of classification is here. Some also believe that if the problem of taxing intangibles can be solved, through classification or some other means, the remainder of the property tax can be rigorously and uniformly enforced. It is doubtful if the general property tax minus intangibles can be successfully resurrected. The taxation of personal property in one category still remains an obstacle. Likewise it is doubtful if the merits of classification rest on the results from taxes on intangibles.

The treatment of intangibles, however, has played a large part in the classification movement.

It was demonstrated many years ago that the classification of intangibles was fundamentally more equitable than their taxation at the same high rates as prevailed for real estate. It was also found to be true, in most states, that the revenue produced by the low-rate taxes exceeded that from the higher rates of the general property tax.[3] Thus greater justice produced greater profits for public treasuries. Some of these gains did not appear until a considerable amount of time had elapsed and no little administrative effort had been exerted. Moreover, without efficient centralized administration the achievements of low-rate taxation of intangibles would have been desultory. Classification is not a self-executing reform; nor do low rates completely reform taxpayers. They have made it possible, however, for them to be reasonably fair with the state in filing tax returns. Psychologically the result has been good—that has made the enforcement of the rest of the property tax easier, but that abundant revenues have not been produced is really no fault of the plan. Had the declarations been perfect, the productivity of these low-rate taxes would still not have come up to the predictions of many ardent campaigners in their behalf. There is no question but that many voters have been led to expect far too much in revenues from classified property taxes of every variety. Justice, not productivity, is their major virtue.

In 1930, a special tax committee in Ohio, after a study of the results of low-rate taxes in other states, emphasized the incompleteness of voluntary assessments under these

[3] *See* Simeon E. Leland, "Results of Operation of the Classified Tax on Intangibles," *Proceedings*, National Tax Association, 1928, pp. 292 ff. and p. 554.

laws and stressed the importance of employing collection-at-the-source wherever possible.[4] The committee had no illusions as to the revenue productivity of these taxes.[5]

In 1932, Blakey in his study of *Taxation in Minnesota* subjected the low-rate taxes of that state to the most searching examination. Whereas Compton and myself had previously attempted to evaluate intangible taxes on the basis of presumptive indices,[6] Blakey sought an answer to the question of the completeness of assessments on the basis of data taken from the examination of 805 estates in 18 counties. He found that only 6.03 per cent of money and credits were taxed and only 17.33 per cent of those taxable were listed. Blakey naturally concluded that there was little to boast of in this record and stated:

> One may raise the question whether such property should not be taxed by some more successful method or removed entirely from the tax rolls. Inasmuch as the physical property underlying most of these intangibles is already taxed, perhaps they should not be taxed at all; or possibly the taxpaying capacity represented by them can be reached more equitably and practically through an income or other tax.[7]

Ford in his recent study of the *Taxation of Intangibles in Michigan* took occasion to analyze the practices of several states, particularly of Ohio, where a comprehensive system

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[4] *Report of the Committee on Taxation of Intangible Wealth,* submitted to Governor's Taxation Committee, Columbus, Ohio, December 24, 1930 (mimeographed), pp. 3 ff. See also *A Study of Low-Rate Taxes on Intangible Property in Various States and Probable Yields of Such Taxes if Applied in Ohio,* Third Preliminary Report of the Committee on Research Submitted to the Governor's Taxation Committee, Columbus, Ohio, November 12, 1930.

[5] *Report of the Committee on Taxation of Intangible Wealth,* submitted to Governor's Taxation Committee, Columbus, Ohio, December 24, 1930, pp. 5–6.

[6] *A Study of Low-Rate Taxes on Intangible Property in Various States and Probable Yields of Such Taxes if Applied in Ohio,* Third Preliminary Report of the Committee on Research submitted to the Governor's Taxation Committee, Columbus, Ohio, November 12, 1930; Leland, *loc. cit.*

[7] Roy G. Blakey, *Taxation in Minnesota,* p. 217.

of classification is in force.[8] The conclusions of this investigation are similar to those heretofore given. For example, Ford believes that the classification of intangibles in Ohio is an improvement over the general property tax even though the taxes levied on intangibles were not so great up to 1937 by several millions as those previously levied under the general property tax.[9] These disappointing results were attributed to the shortness of time within which classification had been effective and to the economic consequences of the depression. Nevertheless, Ford was certain that Ohio had fared better under classification during the depression than would have been the case had the general property tax been continued. The dual administration of the taxes by both state and local authorities also contributed to the disappointing results of the Ohio system. Collection-at-the-source of the bank deposit tax, on the contrary, was quite effective, and in line with the experience of other states. The Ohio system with its differentials among various classes of intangibles has to date contributed little to the improvement of either the theory or the practice of classification.

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[8] Robert S. Ford, *Taxation of Intangibles in Michigan*, Ch. III. The Ohio system of taxing intangibles, in brief, is as follows: Intangibles yielding income are taxable at 5 per cent on income yield; non-income-bearing investments, bank shares, bank deposits, shares in and capital employed by financial institutions, capital and surplus of domestic insurance companies are taxed at 2 mills. Money and credits are taxable at 3 mills. Shares of dealers in intangibles are taxed at 5 mills. *Laws of Ohio,* 1931, p. 722; *Laws of Ohio,* 1933, p. 592; Throckmorton's Ohio Code Annotated, Baldwin's 1936 Certified Revision, §§ 5414-9, 5414-13, 5638-1.

[9] Total Taxes Levied on Intangibles in Millions:

1930............	$23.3 (last year of general property tax)
1932............	18.5
1933............	13.9
1934............	12.2
1935............	14.5
1936............	14.4
1937............	18.4

Ford, *op. cit.*, pp. 95, 99.

The effects of the depression since 1929 have been unmistakably shown in the operation of the low-rate taxes on intangibles. By 1938, however, many states could boast of larger assessments than in 1929. This was true, for example, in Connecticut, Maryland, Minnesota, Rhode Island, Kansas, California, and the District of Columbia,[10] as is shown in Table 1. In Baltimore City, the assessment of this property in 1938 exceeded that of 1929, but that was not true of Baltimore County. In Minnesota, assessments under the 3-mill tax did not start to decline until after 1930, but by 1934 they exceeded all previous assessments and after that date continued to increase sharply each year until 1937; there was a slight decrease in 1938 but in 1939 an all time record in assessments was made.[11] In Rhode Island a similar condition prevailed. The assessment of intangibles continued on the upward trend until 1930, but it was not until 1932 that a marked decrease in valuations was evident. In 1934, assessments started to increase and have mounted steadily each year since that date.[12] On the other hand, marked decreases in assessments have taken place in Iowa, Montana, Nebraska, and South Dakota.[13] In Iowa the assessment of intangibles dropped from $501,000,000 in 1929 to $337,000,000 in 1938; in Nebraska the decline for these years was from $301,000,000 to $106,000,000; in South Dakota from $76,000,000 to $39,000,000. In Montana assessments in 1938 were only slightly less than in 1929—$28,342,000 in 1929 as compared to $26,285,000 in 1938. Whether in this last group of states the low-rate

[10] *See* footnote 27.

[11] *See* Table 1, for assessments under the Minnesota three-mill tax on money and credits.

[12] *See* Table 1.

[13] In Kentucky the assessment of intangibles declined from 1929 to 1932, but after 1932 the assessments began to increase, although the pre-depression level was not reached in the latest available returns. *See* Table 1.

TABLE 1

ASSESSMENT OF INTANGIBLES UNDER LOW-RATE TAXES

(In Thousands)

Year	Pennsylvania			Connecticut		Maryland			Iowa	Minnesota		Rhode Island	Virginia					
	Money at Interest[a]	Corporate Loans[b]	Capital Stock[b]	Choses in Action	Intangibles Locally Assessed[c]	Low-rate Tax on Securities[d]			Money and Credits	Money and Credits	Intangibles not under Money and Credit Tax[e]	Intangibles	Bonds, Notes, etc.	Shares of Stock[f]	Capital[g]	Bonds of Counties, Cities, etc.[h]	Money on Deposit	Moneyed Capital
						Baltimore City and Annex	Baltimore County	All Other Counties										
1928	$2,942,468	Data not available	Data not available	$119,004	$2,016	$447,773	$42,258	$555,231	$517,077	$416,914	$26,652	$239,709	$240,714	$123,544	$201,200	$8,080	$ 97,509	$ 175
1929	3,279,432			113,701	2,311	481,246	50,610	603,216	501,009	436,795	26,566	249,451	255,197	....	188,829	....	100,577	4,087
1930	3,407,198			110,316	2,031	539,224	52,026	666,876	584,190	441,920	26,362	253,300	255,842	....	190,179	....	98,301	2,695
1931	3,325,798			106,317	1,863	593,542	59,592	728,863	538,548	418,953	24,989	250,682	250,724	....	170,346	....	95,808	2,376
1932	2,749,929			99,142	1,395	517,083	53,690	631,870	469,202	402,073	22,086	208,826	227,671	....	146,423	....	89,908	1,220
1933	2,650,195			95,206	1,135	324,148	35,866	410,619	338,271	415,218	18,896	207,523	199,541	....	130,139	....	88,463	1,362
1934	2,392,906			96,845	1,161	330,288	34,006	413,011	333,430	475,460	16,854	208,573	185,254	....	144,006	....	84,882	476
1935	2,297,551			103,277	866	361,231	36,919	450,585	334,696	559,562	18,123	211,827	172,142	....	160,163	....	95,284	553
1936	2,841,309			104,497	1,030	361,510	39,278	464,665	339,498	667,959	15,574	232,930	163,600	....	161,804	....	104,334	545
1937	....			116,080	1,013	421,624	44,043	557,024	348,078	713,571	20,790	383,511	161,216	....	178,822	....	114,313	751
1938	....			123,111	977	488,908	49,707	629,548	337,199	684,149	21,474	395,421	157,673	....	185,598	....	117,243	784
1939	....			....	....	415,163	60,108	571,064	341,036[t]	765,141	22,538	370,868	....	....	....	....	....	....

Year	Kentucky		District of Columbia	Montana		So. Dakota	Nebraska	Kansas	California			Vermont	
	Intangibles[i]	Bank Deposits[j]	Intangibles[k]	Solvent Credits	National Bank Stock; Moneyed Capital	Intangibles[l]	Intangibles[m]	Money and Credits	Solvent Credits	Stocks, Bonds, Notes, etc.	Total	Intangibles	
												Group I	Group II[n]
1928	$535,171	$360,214	$495,908	$39,869	$9,894	$74,622	$172,562	$146,524	$98,709	....	$ 98,709[o]	$77,835	$8,289
1929	638,249	364,361	524,565	28,342	12,210	76,045	300,783	149,860	411,890[p]	$1,105,328	1,517,218	84,991	8,483
1930	557,572	345,305	545,188	30,465	12,995	76,637	242,115	[q]	508,809	1,315,135	1,823,944	94,223	8,448
1931	430,161	302,716	548,597	32,935	11,811	73,211	206,321	219,198	358,058	835,246	1,193,304	93,922 [r]	8,051 [r]
1932	254,891	238,605	509,488	27,089	10,327	62,003	150,962	205,353	292,647	510,290	802,937		
1933	334,325	220,601	364,640	23,122	9,413	53,589	119,704	167,222	279,855	435,837	715,692	....	....
1934	328,334	236,450	410,431	23,686	8,440	47,660	103,079	159,641	541,203	1,168,961	1,710,164	....	....
1935	342,677	264,969	408,705	23,532	7,561	43,814	104,081	163,614	503,498	924,156	1,427,654	....	....
1936	398,152	289,662	420,953	24,280	8,225	43,965	110,960	171,618	578,477	....	578,477	....	....
1937	437,715	306,689	524,978	27,106	9,974	42,659	115,662	188,757	738,089[s]	....	738,089	....	....
1938	....	....	575,472	26,285	10,425	39,319	106,259	191,293	644,702[s]	....	644,702	....	....
1939	....	....	....	26,003	10,950	32,142[u]	110,788	188,340	664,372	....	664,372	....	....

The writer is indebted to public officials in the states covered by these data for assistance in making them available and also for verification of information. The assistance of Mr. Robert E. Kronemyer in compiling these data is also acknowledged

[a] County tax — rate 4 mills. Data not yet available for 1937, 1938, and 1939. (Letter from Bureau of Statistics, March 7, 1940.)

[b] "Impossible to compile from records immediately available." (Letter from Budget Secretary, February 13, 1940.)

[c] Excluding commercial deposits, which were exempted by law in 1926.

[d] For County purposes. Law taxing intangible securities repealed as of January 1, 1940.

[e] Includes bank stock as well as other bonds and stocks.

[f] Section 71 of the Tax Code, taxing shares of stock as property, was repealed January 1, 1929.

[g] Excluding moneyed capital, which is shown in separate column.

[h] Section 72 of the Tax Code, taxing bonds of counties, cities, etc., was repealed on January 1, 1929.

[i] Does not include bank stock. Intangible personal property is assessed by county commissioners.

[j] Assessed by State Tax Commission.

[k] Assessment figures obtained by capitalizing at 5/10 of 1 per cent the tax figures given in 1938 Report on the Finances of the District of Columbia.

[l] Intangibles assessed under personal property tax through 1930; then separately.

[m] Includes bank stock.

[n] Bank stock only.

[o] Assessment under 7% law of 1925. Includes money and solvent credits only.

[p] Assessment for 1929 and after under the 1.45% law. Includes intangibles assessed locally as well as by the State Board of Equalization. Money retained under general property tax.

[q] Money and Credits law repealed; re-enacted in 1931.

[r] Intangibles tax law replaced by Income and Franchise Law of December 1, 1931.

[s] State and County assessment combined.

[t] Tentative figure, furnished by Iowa Tax Commission. Includes $25,990 Bank Stock to be taxed at 6 mills.

[u] Before equalization.

taxes stood up better during the depression than other parts of the property tax, the writer has not had time to determine. In other cases, it appears that the improvement in assessments under low-rate taxes has not been shared by other parts of the property tax. How much of this improvement is due to more complete listing of intangibles, how much to increase in ownership of this property, and how much to better administration is not known.

Extra-Legal Classification in Cook County

Although administration has played an important part in the success of low-rate taxation, it is not the only factor to emphasize. This is indicated by recent experience in Cook County, Illinois, where extra-legal classification in one form or another has been the rule almost since 1898.[14] This classification is purely administrative. At first the privileges of classification were limited to a few select friends and campaign contributors; later the system was extended to banks and others but still confined to "those who know"; about 1932 a "friend" of the assessor notified the community that the assessor would respect "custom and usage" with reference to intangibles; [15] finally, a few

[14] *Cf.* Altman, *Chicago's Experiment in Personal Property Taxation: 1931–36,* especially Chs. I, II, and VI.

[15] These recommendations were made by Mr. George O. Fairweather in *Appraisal Standards for the Assessment of Personal Property,* Report V, Joint Commission on Real Estate Valuation, Cook County, Illinois, July, 1932, pp. 11–12, as follows:

Item 26—moneys of other than bank, banker, broker or stock jobber. Money of banks and money belonging to domestic corporations is not assessable as such, being one of the elements going to make up the assessable value of the capital stock. In other jurisdictions where moneys are taxed as property, an effective rate on the average of 2.2 mills is employed. This rate does not tend to precipitate the flight of deposits from such jurisdictions. For purposes of comparison only, a similar result in Cook County would be had under local rates and equalization factor, on a basis of 10 per cent. For example, at a $6 rate and 37 per cent equalization factor, the use of this percentage would produce a tax of $2.22 per $1,000.

years ago, the assessor publicly promulgated an administrative twofold classification of intangibles for the benefit of the whole community. In 1936 federal income tax returns were made available to the assessor to enable him to make better estimates of taxable securities. This information was used in making the 1937 assessment. At present, money, cash, and bank deposits are assessed at 10 per cent of their value, or at 10 per cent of twenty times their annual income, whichever is lower.[16] In the case of cash and

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Item 27—credits of other than bank, banker, broker or stock jobber. The general intent of the statute is to balance current debts against current credits, excluding all productive investments, such as notes given as security for money loaned. Notes or other obligations for money loaned are added to the net credits, if any. With regard to the appraisal value to be assigned to such obligations (such as notes secured by mortgage or trust deed) an appraisal of 20 per cent of the value produces a 4.4 mill tax or twice as much as the net rate on money as employed in other jurisdictions, as indicated under Item 26 above. On a 6 per cent mortgage this rate takes approximately 7 per cent of the income; on a 5 per cent mortgage this rate takes approximately 9 per cent of the income; on a 4 per cent mortgage this rate takes approximately 11 per cent of the income. The effective tax thus developed is comparable to and in most cases higher than any income tax rate. In 17 states having a mill tax on this subject matter, the average runs between four and five mills.

Item 28—bonds and stocks. See Item 27 above. (There is a common and mistaken notion that municipal obligations are tax exempt. This may be due in part to the fact that representations are said to have been made at the time of the sale of such obligations that they are exempt from personal property tax.)

[16] See instructions of assessor as printed on assessment schedules for 1939 as follows:

Item No. 12. Money, Cash, and Bank Deposits: List cash on hand and on deposit as of the assessment date at ten (10) per cent of full amount, or at ten (10) per cent of twenty (20) times the annual income, whichever is lower; provided, however, that in the case of cash and bank deposits the annual income rate shall be taken to be not less than two (2) per cent.

Item No. 13. Net Credits: List accounts as computed from memoranda on the front page of assessment schedule at ten (10) per cent of the amount determined. Credits are receivables; deductions are payables.

Item No. 14. Taxable Stocks and Bonds: List taxable stocks and bonds at either ten (10) per cent of the market value as of the assessment date, or at ten (10) per cent of twenty (20) times the annual income for the preceding year, whichever is lower. Where no income is derived from certain securities, the annual income rate shall be taken to be two (2) per cent of the market value as of the taxable date. Where the fair cash

bank deposits, the annual income is not to be taken at less than 2 per cent, which means that this property is to be assessed at 4 per cent. This system is used also on non-income-bearing securities. Stocks and bonds of the income-yielding variety are assessed at 10 per cent or at 10 per cent of 20 times their income, whichever is lower.[17] This is substantially the system of classification that has prevailed in Cook County in recent years. At times bank deposits and non-income-bearing securities have been assessed at 10 per cent, while other personal intangibles have been assessed at 20 per cent. Still other rules have prevailed for corporate intangibles (corporate excess), tangible personalty and real estate. Prior to 1930, however, no effort was made to assess intangibles. As a result, the assessment of money, stocks, bonds, net credits, notes and mortgages was only $4,654,000 in 1930 and $6,162,000 in 1929. These sums were less in those years than the assessment of intangibles in any state having low-rate taxes.

After 1930 a determined effort was made to increase the assessment of intangibles with the result that the 1931 assessment rose to $90,410,000. Subsequently, as is shown in Table 2,[18] the total assessment of this property declined to $63,529,000 in 1932. Thereafter it increased fairly continuously until in 1937 the assessment of intangibles reached an all-time high of $163,830,000. After that assessment was completed, the assessor cut his valuation system

value of any security is incapable of ascertainment under the above rules and guides the particular facts which take it out of the rule must be stated on the schedule or letter and the method determining the fair cash value endorsed thereon.

Item No. 15. Mortgages and Notes: Use same method as outlined in Item No. 14.

[17] *Ibid.*

[18] In order to facilitate comparison, corporate intangibles and other personal property are also shown. The first four items on the table and the subtotal embrace the intangibles described in the text.

in half, with the result that assessments fell to a little less than \$79,000,000 in 1938.[19] For the assessment year 1937, federal income tax returns were utilized by the assessor, and, as a consequence, the assessment of stocks and bonds alone more than doubled, rising from \$64,000,000 in 1936 to \$145,000,000 in 1937.

This record in Cook County indicates progress in increasing assessments. It is no mean achievement for a local assessor. Nevertheless, the record of Chicago (Cook County) is disappointing (prima facie) if comparisons are made with assessments in other places. In 1938, the assessment of intangibles in Cook County was less, for example, than the assessment of intangibles in Connecticut, Nebraska, or Kansas. In Baltimore, the assessment of intangibles was six times greater than in Cook County; in the District of Columbia, it was seven times greater; in Iowa, it was four times greater. The assessment of intangibles under the three-mill tax in Minnesota reached \$684,000,000 almost without effort, while the most rigorous use of information collected-at-the-source produced an assessment of less than \$79,000,000 in 1938 in Cook County, Illinois.

Of course, the results in Cook County are limited by the restricted jurisdiction in which the tax is enforced. While Cook County is one of the most populous counties in the Union it does not include all of those who earn their living in Chicago. Rigorous enforcement of tax laws within such an area—particularly if intangibles were taxed at high rates—might increase the flight of well-to-do residents from the city and county, as well as stimulate the creation of

[19] In 1937 bank deposits and cash were assessed at 10 per cent while securities were assessed at 20 per cent. In 1938 these percentages were reduced to 4 per cent and 10 per cent respectively.

TABLE 2

PERSONAL PROPERTY LOCALLY ASSESSED, BY CLASSES, COOK COUNTY, ILLINOIS
Assessment years 1929–1938

(In Thousands)

Classes of Property	1938	1937	1936	1935	1934	1933	1932	1931	1930	1929
....	$4,172	$4,176	$2,817	$4,661	$8,022	$6,290	$5,352 [a]	$32,347 [b]	$2,927 [b]	$3,558 [b]
dits........................	3,758	9,840	7,346	7,401	6,316	7,134	48,647 [a]	6,275 [c]	1,196 [c]	1,864 [c]
and bonds..................	68,358	145,699	64,011	63,036	17,133	14,447	9,530 [a]	51,788	531 [d]	740 [d]
ges and notes...............	2,656	4,115	2,671	3,877	50,071	36,863	[e]	[e]	[e]	[e]
f intangible items above......	78,944	163,830	76,845	78,975	81,542	64,734	63,529	90,410	4,654	6,162
of stock of state and national s........................	24,536	26,573	19,776	17,940	19,444	24,871 [a]	50,175	72,973 [f]	90,787	95,740
stock of domestic corporations.	22,383	24,337	13,603	13,375	25,246	27,245 [a]	10,773	1,642	172,779	62,896
eipts of *insurance companies*...	5,864	3,099	3,926	2,755	2,327	3,974	9,351	7,825	4,951 [g]	5,076 [g]
ıtangible items separately listed	....	....	....	....	....	....	448 [h]	396 [i]	52 [i]	16 [i]
le personal property..........	342,389 [j]	346,341 [j]	318,626 [j]	344,380 [j]	429,600 [j]	532,619 [j]	359,512 [f]	206,944 [f]	168,675 [f]	179,420 [f]
her property"...............	7,299	10,922	9,851	11,178	10,798	11,107	211,837	453,290 [a]	298,802	326,382
es........................	46,240	64,365	44,153	53,962	101,272	119,387	108,836	88,793 [a]	29,142 [a]	....
otal of all personal property...	$527,655	$639,467	$486,780	$522,565	$670,229	$783,937 [k]	$814,461	$922,273	$769,842	$675,692

writer is indebted to Mr. G. W. Mitchell, of the Illinois Tax ssion, for assistance in computation of these data.

imated — Altman, Oscar L. *Chicago's Experiment in Per- roperty Taxation*, 1931–1936, p. 87.

mposed of "Money of Banks, Bankers, Brokers, etc." and ys of Others than Bankers, Brokers, etc."

mposed of "Credits of Banks, Bankers, Brokers, etc." and ts of Others than Bankers, Brokers, etc."

mposed of "Bonds and stocks" and "Shares of capital stock panies not of this state."

luded in stocks and bonds.

ludes horses, mules, cattle, sheep, hogs, steam and gasoline , boilers, carriages, wagons, automobiles, trucks, motor cycles, oats, sailing vessels and other craft, watches, clocks, sewing itting machines, piano fortes, melodeons, organs, radios, phono- , gold and silver plate, diamonds and jewelry, fire-proof safes, ndise, material and manufactured articles, manufacturers' nd machinery, agricultural tools and machinery, property of ations not enumerated before, bridge property, household and roperty; property of pawnbrokers, saloons and eating houses, of telegraph and telephone companies, oil, gas and waterpipe lines, of electric light and power companies, of gas companies, of auto repair and service garages, of abstract companies, of billiard halls and bowling alleys, of cleaners and dyers, and of newspapers and printers; electric signs and billboards, grain of all kinds, motion picture equipment.

[g] Designated on abstract as "Franchises" but probably is largely "net receipts of insurance companies."

[h] Designated as "Franchises, Annuities, Royalties and Patent Rights" and "Building and Loan Associations."

[i] Consists of following items on abstract: "Franchises," "Annuities," "Patent Rights," "Investment in Real Estate and Improvements Thereon."

[j] Includes passenger automobiles, trucks and busses, cattle, horses and mules, sheep and goats, swine, household furniture and furnishings, office and store furniture and fixtures, personal effects, machinery and equipment, merchandise (goods on hand and in process).

[k] The County Clerk has included in his certified abstract $400,000 in omitted property not included here.

non-resident trusts. More important than the area of tax jurisdiction is the fact that the Cook County classification rests on a shaky legal foundation. The constitution of the state specifies the uniform rule. The courts have not been called upon to pass upon the assessor's classification scheme directly. Many competent lawyers think it is illegal; others are in doubt, none seem to be cocksure of its constitutionality. This fact, together with the high tax rates prevailing in the area does not provide a fertile field for the cultivation of voluntary listing. Although the use of federal returns has improved assessments they do not provide a perfect check for valuations. In addition, they have been used only two years. This is hardly long enough to enable one confidently to predict what may be accomplished from their use in the long run. Moreover, the organization of assessment machinery in Cook County is far from ideal. The work of the assessor is reviewed by a locally-elected board of appeals. The county treasurer (an elected officer) acts as the tax collector, or receiver of payments. Assessments are defended and legal actions to enforce tax payments are the duty of another elected official. This division of responsibility prevents the attainment of best results in the taxation of any property in Cook County, whether tangible or intangible. Each year the board of appeals orders substantial reductions in assessments made by the assessor. The system can only be appraised on the basis of the resulting assessments and tax collections. These leave much to be desired, but there is little doubt but that the assessor is making a conscientious and determined effort to tax intangibles at rates believed by the community to be fair. Nevertheless, the assessment of intangibles seems to be far from complete, though they are an improvement over past practices in the county. If questions of the legality of

classifying intangibles were definitely settled, even better results would be sure to ensue. Of course, the many handicaps to the effective use of administrative classification in Cook County must be recognized. These limitations are serious handicaps to any experiment.

The foregoing comparisons, based on assessed values, do not seem, however, to do full justice to the Cook County experiment. Classification was there achieved by the relative underassessment of intangibles rather than through rate differentiation as in most of the classification states. For example, in 1938, real estate in Cook County was assessed, on the average, at 30 per cent of its value.[20] The average tax rate in the county was \$8.70 per \$100, or an effective rate of \$2.60 for such property as was assessed at its full market value.[21] For such intangibles as were listed at 10 per cent of full value this meant an effective rate of 26 mills; for money on deposit similarly declared (but listed at 4 per cent of its value) the effective rate would be 10.4 mills. For intangibles assessed on the basis of income yields the effective rates would vary, depending upon the yield of the securities. In jurisdictions achieving classification through rate differentiation it is presumed that intangibles are listed at full value. This is a mere presumption, and, inasmuch as other property is seldom so assessed, it is doubtful if the assessments of intangibles are either complete or at full value under the low-rate tax laws. Cer-

[20] *Survey of Local Finance in Illinois,* Vol. II, *Property Taxation: Assessed Valuations, Tax Rates and Extensions,* prepared by the Illinois Tax Commission, 1939, p. 17.

[21] The average tax rates per \$100 of valuation in Cook County, Illinois, are as follows:

1927	\$4.93	1931	\$7.02	1935	\$7.97
1928	5.07	1932	7.37	1936	8.99
1929	5.92	1933	6.28	1937	8.33
1930	6.43	1934	6.87	1938	8.70

tainly the study of Blakey in Minnesota indicates that they are not.[22] It is also doubtful whether the situation is any different in California or Montana, for example, where fractional assessments on intangibles have been employed, and where other property has been notoriously undervalued. But just what ratios of assessed to full value of intangibles have prevailed in the classification states has never been determined. Nevertheless it seems unfair (or at least a dubious practice) to compare assessments in jurisdictions achieving classification via fractional assessments with those in other jurisdictions where rate differentiations prevail. At the risk, however, of doing violence to the latter group of states the estimated full value of intangibles in Cook County will be employed as the basis of comparison with assessments under the millage laws.

In order to make clear the difference between the assessed and the full value of intangibles in Cook County, both facts have been presented in Table 3. The estimated full value of intangibles other than money, in spite of efforts to be accurate, may be somewhat erroneous, due to uncertainties as to the market value of intangibles listed on the basis of income yields, as well as to those listed at prescribed minimum figures. It is believed that these errors are not serious and that the full-value estimates approximate the true situation. The accompanying data indicate a steady improvement in full-value assessments. This is true also from 1936 to 1938 where a change in the listing policies of the assessor in 1938 greatly reduced the actual assessments in that year.

If the full value of intangibles in Cook County for 1937 and 1938 are compared with assessments in other states (keeping in mind the possibility of bias) the results in this county are favorable in the extreme. They are greatly in

[22] Blakey, *op. cit.*

TABLE 3

Assessed and Estimated Full Value of Selected Classes of Intangible Personalty Locally Assessed, Cook County, Illinois, 1929–1939

(In Thousands)

ASSESSED VALUES

	1938	1937	1936	1935	1934	1933	1932	1931	1930	1929
Money	$4,172	$4,176	$2,817	$4,661	$8,022	$6,290	$5,352	$32,347	$2,927	$3,558
Net credits, stocks, bonds, mortgages, notes	74,772	159,654	74,028	74,314	73,520	58,444	58,177	58,063	1,727	2,604
Total	$78,944	$163,830	$76,845	$78,975	$81,542	$64,734	$63,529	$90,410	$4,654	$6,162

FULL VALUES

	1938	1937	1936	1935	1934	1933	1932	1931	1930	1929
Money [a]	$281,892	$112,865	$76,135	$125,973	$216,811	$170,000	$144,649	$874,243	—	—
Net credits, stocks, bonds, mortgages, notes [b]	2,526,081	2,157,486	1,000,378	1,004,243	993,514	789,784	786,176	784,635	—	—
Total	$2,807,973	$2,270,351	$1,076,513	$1,130,216	$1,210,325	$959,784	$930,825	$1,658,878	—	—

The writer is indebted to Mr. G. W. Mitchell, of the Illinois Tax Commission, for assistance in compiling these data.

[a] Conversion to full value for money based upon a return of 10% of fair cash value equalized at 37% for the years 1931–1937, inclusive, and upon a return of 10% of 20 times the income, or 2% of fair cash value equalized at 37% for the year 1938.

[b] Conversion to full value for net credits, stock and bonds, mortgages and notes based upon a return of 20% of fair cash value equalized at 37%, years 1931–1937, inclusive, and upon a return of 10% of 20 times the income yield equalized at 37% for the year 1938. Securities yielding no income were valued in 1930 on the basis of an assessed yield of 2%. If an average yield of 4% for the entire category is used, the conversion factor would be 2.96%.

excess of assessments in every state.[23] Assessments under the Minnesota three-mill money and credits tax were approximately one-third of the Cook County full values. Assessments in Maryland were even further behind.

This method of analysis, as has been indicated, involves many pitfalls arising in connection with comparisons of assessments made by different authorities, under different rules, under varying conditions, and with different standards of value. Some of these difficulties can be avoided by noting the revenue results from the various plans. Such comparisons must be based on potential yields,[24] because actual collections are seldom available, and where they can be secured, may reflect administrative difficulties not connected with the intangibles taxes per se. The use of potential yields as a basis of comparison is not completely satisfactory, but it is probably superior to the comparisons just made. At any rate, comparisons on the yield basis will round out the analysis of the Cook County experiment.

Potential Revenue Yields from Preferential Taxes

The data in Table 4 give the potential revenue yields from preferential taxes on intangibles in the District of Columbia, Minnesota, Maryland, Rhode Island, and Virginia, as well as for Cook County, Illinois. From these data the greater productivity of the Cook County experiment is plainly evident. Wide fluctuations in tax yields in that county since 1929 can also be observed, but it is to be remembered that a determined effort to enforce the taxation of intangibles did not commence until 1931. Not only were

[23] Data on assessments in Pennsylvania are not available and cannot reliably be estimated at this writing (letter from the Budget Secretary, February 13, 1940).

[24] These are found by multiplying assessments by tax rates, with no allowance for delinquency or losses in collections.

potential tax yields in Cook County higher in 1938 than those for states shown on the accompanying table, but they were also greater than yields in Connecticut, Iowa, Kentucky, Montana, South Dakota, Nebraska, and Kansas, as may be seen from Table 5. These data indicate that the Cook County experiment has been far more successful (on

TABLE 4

POTENTIAL REVENUES FROM CERTAIN LOW-RATE TAXES ON INTANGIBLES (In Thousands)

Year	Cook County Illinois[a]	District of Columbia	Minnesota	Maryland	Rhode Island	Virginia
1929	$ 364	$2,622	$1,310	$2,616	$ 997	$2,934
1930	299	2,725	1,325	2,895	1,013	2,929
1931	6,346	2,742	1,256	3,116	1,003	2,746
1932	4,682	2,547	1,206	2,716	835	2,428
1933	4,065	1,823	1,245	1,774	830	2,164
1934	5,601	2,052	1,426	1,786	834	2,180
1935	6,294	2,043	1,778	1,933	847	2,258
1936	6,908	2,104	2,003	2,006	931	2,245
1937	13,647	2,624	2,140	2,416	1,534	2,383
1938	6,868	2,877	2,052	2,735	1,581	2,422

[a] Taxes on first four items of Table 2, representing roughly the amount of individually-owned intangibles.

its face) as a revenue device than other classification measures. A definitive conclusion cannot be reached, however, until the results are compared on the basis of relative wealth and ownership of intangibles in the various jurisdictions. It is unfortunate that neither time nor data are available for the performance of this task. It is nevertheless clear that the results achieved through administrative classification in Cook County can neither be deprecated nor ignored.

If time permitted it would be interesting to bring to date the writings and researches on other classification de-

TABLE 5

POTENTIAL REVENUES FROM CERTAIN LOW-RATE TAXES[a]

(In Thousands)

Year	Pennsylvania				Connecticut		Maryland	Minnesota	Iowa	Rhode Island
	County Tax on Money at Interest[b]	State Tax on Personalty[c]	Corporate Loan Tax[d]	Capital Stock Tax[e]	Chose in Action Tax[f]	Intangibles Locally Assessed[g]	Low-Rate Tax for State and County Purposes[h]	Tax on Money and Credits[i]	Tax on Money and Credits[j]	Tax on Intangibles[k]
1928	$11,769	.....	$4,195	$20,428	$476	.....	$2,401	$1,250	$3,102	$958
1929	13,117	.....	4,592	17,999	454	$47	2,616	1,310	3,006	997
1930	13,628	.....	4,752	19,637	442	56	2,895	1,325	3,505	1,013
1931	13,303	.....	4,884	17,289	425	44	3,116	1,256	3,231	1,003
1932	10,999	.....	4,716	14,383	396	44	2,716	1,206	2,815	835
1933	10,600	.....	4,493	15,428	381	29	1,774	1,245	2,029	830
1934	9,571	.....	4,396	15,427	387	28	1,786	1,426	2,000	834
1935	9,190	.....	4,878	28,604	413	30	1,933	1,778	2,008	847
1936	11,365[y]	$3,558	6,472	29,984	419	23	2,006	2,003	2,036	931
1937	.....	15,767	6,727	26,219	464	23	2,416	2,140	2,088	1,534
1938	.....	11,752	5,963	22,156	492	25[aa]	2,735	2,052	2,023	1,581
1939	.....	11,642	6,458	27,935	...	25[aa]	2,514	2,295	2,046[bb]	1,483

Year	Virginia	Kentucky	District of Columbia	Montana	South Dakota	Nebraska	Kansas	California	Vermont	
									Tax on Intangibles	
	Tax on Intangibles[l]	Tax on Intangibles and Bank Deposits[m]	Tax on Intangibles[n]	Money and Credits Tax[o]	Tax on Intangibles[p]	Tax on Intangibles[q]	Money and Credits Tax[r]	Tax on All Intangibles[s]	Group I[t]	Group II[u]
1928	$2,046	$2,837	$2,479	$154	$298	$698	$743	[v]	$311	$33
1929	1,518	3,129	2,622	115	304	1,537	777	$2,623	339	34
1930	1,502	3,536	2,725	121	306	1,320	[w]	3,139	377	34
1931	1,469	3,089	2,742	140	292	1,167	1,107	2,028	376	32
1932	1,330	2,388	2,547	116	248	894	1,035	1,314	[x]	[x]
1933	1,188	1,494	1,823	105	214	721	816	1,152	...	..
1934	1,100	1,878	2,052	115	190	573	799	2,879	...	..
1935	1,056	1,978	2,043	118	175	575	824	2,351	...	..
1936	1,032	2,029[z]	2,104	114	175	623	858	578	...	..
1937	1,042	2,365[z]	2,624	102	170	670	943	738	...	..
1938	1,030	2,565[z]	2,877	100	157	613	956	644	...	..
1939	.....	.....	.....	93	...	664	948	644	...	..

The writer is indebted to public officials in the states covered by these data for assistance in making them available and also for verification of information. The assistance of Mr. Robert E. Kronemyer in compiling these data is also acknowledged.

[a] Data represent tax levies except in those few cases where actual receipts are indicated.
[b] Rate 4 mills.
[c] Actual receipts applying to each year regardless of date of collection. State tax on personalty became effective January 1, 1936. Rate 1 mill in 1936, 4 mills, 1937 and after.
[d] Actual receipts, from domestic and foreign corporations combined, applying to each year from 1930 to 1938, inclusive, regardless of date of collection. Rate 4 mills up to and including 1934, 5 mills in 1935, and 8 mills in 1936 and after.
[e] Actual receipts, from domestic and foreign corporations combined, applying to each year from 1930 to 1938, inclusive, regardless of date of collection. Rate 5 mills.
[f] Rate 4 mills.
[g] Actual receipts. Intangibles locally assessed are taxed at same rate as real estate.
[h] State rate 1½ mills.
[i] Rate 3 mills.
[j] Rate 6 mills.
[k] Rate 4 mills.
[aa] Estimate of collections.
[bb] Tentative figure furnished by Iowa Tax Commission.

[l] Items included shown on Table I of Appendix. Rates: bonds, notes and other evidences of debt, 5 mills; money, 2 mills; shares of stock (not taxed after 1928), 5 mills; bonds of political subdivisions of the State (not taxed after 1928), 3½ mills; moneyed capital coming into competition with national banks, 11 mills in 1928 and 10 mills thereafter.
[m] Intangibles assessed by the County Tax Commissioners for all years; bank deposits by the State Tax Commission until 1934, and later by the Department of Revenue. Rates: Intangibles 5 mills; bank deposits 1 mill.
[n] Rate 5 mills.
[o] Estimated on basis of average rate for all purposes exclusive of cities and towns.
[p] Rate 4 mills.
[q] Represents state's one-sixth part of total intangible tax levied. Includes money assessed at 2½ mills and other intangibles assessed at 5 mills for 1928. After 1928 includes money assessed at 2½ mills and other intangibles at 8 mills.
[r] Rate 5 mills.
[s] Up to and including 1935 includes tax on solvent credits at 10¢ rate, and tax on stocks, bonds, notes, etc. at 20¢ rate. For 1935 and after represents tax on solvent credits at 10¢ rate, other intangibles no longer being taxable at special low rates, by reason of the enactment of a personal income tax in 1935. (See Sec. 3627a Pol. Code.)
[t] Excluding bank stock. Rate 4 mills.
[u] Bank stock only. Rate 4 mills.
[v] "There was so much confusion in the interpretation of the laws during the period prior to 1929 that we hesitate to attempt to complete your table . . for 1928." (Letter from California State Board of Equalization, Feb. 3, 1940)
[w] Money and credits law repealed; re-enacted in 1931.
[x] Intangibles Law repealed Dec. 1, 1931.
[y] Latest available figure.
[z] Actual receipts. Other years show tax levies.

vices. Unfortunately this is not possible. The most that can be done is to venture a few additional observations on comprehensive classification schemes and then attempt a general evaluation of classification.

Comprehensive Classification Schemes

The comprehensive classification schemes are found by law in Kentucky, Minnesota, Montana, Ohio, Virginia and West Virginia. Within given states many of the classifications have little to recommend them. They are based upon questionable assumptions, reflecting political or other pressures rather than sound economic distinctions. Moreover, the more numerous the subdivisions into which property is divided the more questionable from the viewpoint of economic logic do the classifications and the rate differentials become. It is easy to point out defects in particular classifications—and many of the criticisms are rooted in personal opinions and economic beliefs subscribed to by the critics—but it is extremely difficult to say just what the classifications should be and far more difficult to lay down principles on which rate differentiations may be fixed. These questions, in considerable part, lie in the field of policy determination—in the field of practical statesmanship—rather than in the field of economic logic or of public finance in its usual narrow sense. The classification policies, however, must be evaluated in terms of their effects, taking into account social, political and economic results. This task involves far more research than is at the moment available. Attention must, unfortunately, be restricted to the mere mention of legislative policies. It is to be noted that Kentucky still subsidizes manufacturing; Minnesota still discriminates against its iron resources but not as heavily as before; Ohio draws a line between tangible personal prop-

erty and personal property used in business, and between productive and unproductive investments; West Virginia differentiates between rural and urban property, as does Minnesota. Agricultural products are accorded preferences in Kentucky, Minnesota, Montana, Ohio and West Virginia. Household goods are specially classified in Minnesota and Montana. A number of other states also exempt such property.

Some of the systems, thus, seem to provide a difference in treatment for producers and consumers goods. Both from the standpoint of *ad rem* taxes and from the use of property as a criterion of personal capacity this distinction seems to be basically sound. Few of the systems which have such subclasses of property seem to have applied this differentiation fully. In 1919, the Committee on Model Plan for State and Local Taxation recommended a separate classification for tangible personalty as distinct from real estate, it being recommended to exempt intangibles. The rate suggested for tangibles was not to exceed $1.00 per $100 and minimum exemptions of $200 to $400 were suggested.[25] In 1933, when the National Tax Association received a Second Report from its Model Plan Committee, it was reported that the Committee differed with reference to the desirability of classifying tangible property.[26] Professor Bullock thought that tangible personalty should be classified, the other members of the Committee did not. The Committee seemed to be swayed by revenue considerations and the belief that legislatures would not willingly classify tangible personalty. An additional reason was advanced, to wit: "the success which has attended efforts made in some communities to tax tangible personalty more

[25] *Proceedings of National Tax Association,* 1919, p. 445.
[26] *Ibid.,* 1933, pp. 383-384.

effectively under the general property tax." In a footnote the Committee cited Chicago as perhaps the best example of a community which was trying to rejuvenate the personal property tax. The recent experiment in Chicago seems to lead to the same conclusions as previous attempts to tax personal property under general property tax conditions. The progress of this continuing experiment is shown in Table 6.

Expediency here as elsewhere is seldom an adequate answer to the problem of taxation, even so far as classification is concerned. Rigid enforcement has been tried frequently enough to indicate to students of property taxation the probable outcome of such efforts. Rigid enforcement does not provide the alternative to classification. Moreover, the enforcement methods employed have not yet been rigorous enough to produce either adequate or complete assessments of personal property. It is doubtful if taxpayers are yet willing to accede to the kind of administrative methods needed to produce even reasonably complete inventories of personal property. Vigorous efforts to enforce the property tax have been attempted before but there is little reason to believe that this portion of the property tax can be so rejuvenated that it will operate equitably as between taxpayers. It can be administered so as to produce more revenue but to do this will require continuous as well as large amounts of administrative effort.

If we look at the progress of the movement for classification it appears that it is now definitely on the wane. It is not a major problem in state and local finance. These units have recently been seeking lucrative sources of additional revenue. They have turned to sales taxes, income taxes and other devices to get the revenues required for depression or current needs. The limited revenue-raising pro-

TABLE 6

Personal Property Assessments
Cook County, Illinois
1929–1938[a]
(In Thousands)

Classes of Property[b]	1938[e]	1937	1936	1935	1934[f]	1933[f]	1932	1931	1930	1929
Passenger autos	$6,088	$6,657	$10,550	$5,723	$9,688	$13,231	$14,166	$13,194	$3,137	$3,633
Trucks and busses	4,658	4,606	3,480	2,672	2,839	3,287	c	c	c	c
Cattle	184	194	186	161	131	186	187	217	468	468
Horses and mules	141	137	139	166	142	167	155	269	309	401
Sheep and goats	3	2	4	9	3	7	2	1	3	6
Swine and hogs	12	9	10	12	6	14	7	9	28	32
Household furniture	10,255	12,062	21,843	41,739	43,436	82,488	142,246[h]	2,346	297	408
Office and store furniture	21,808	21,854	18,512	21,992	36,086	45,003	2,015	29,156[j]	64,407[j]	68,905[j]
Personal effects	4,161	4,847	7,977	6,256	28,752	39,042	1,045	1,840	346	391
Machinery and equipment	185,326	187,412	173,155	166,062	205,161	250,726	121,776	77,106	69,892	64,917
Merchandise	109,753	108,561	82,770	99,588	103,356	98,468	77,913	82,806	29,788	40,259
Money	4,172	4,176	2,817	4,661	8,022	6,290	5,352	32,347	2,927	3,558
Net credits	3,758	9,840	7,346	7,401	6,316	7,134	48,647	6,275	1,196	1,864
Stocks and bonds	68,358	145,699	64,011	63,036	17,133	14,447	9,530	51,788	531	740
Mortgages and notes	2,656	4,115	2,671	3,877	50,071	36,863	c	c	c	c
Capital stock[d]	22,383	24,337	13,603	13,375	25,246	27,245	10,773	1,642	172,779	62,896
Bank shares	24,536	26,573	19,776	17,940	19,444	24,871	50,175	72,973	90,787	95,740
Other intangible items separately listed	....	....	....	....	....	....	448	396	52	16
All others	7,299	10,922	9,851	11,178	10,798	11,107	211,837[i]	453,290[i]	298,802[i]	326,382[i]
Total	475,551	572,003	438,701	465,848	566,630	660,576	696,274	825,655	735,749	670,616
Insurance	5,864	3,099	3,926	2,755	2,327	3,974	9,351	7,825	4,951	5,076
Penalties	46,240	64,365	44,153	53,962	101,272	119,387	108,836	88,793	29,142	c
Total by local assessor	527,655	639,467	486,780	522,565	670,229	783,937[g]	814,461	922,273	769,842	675,692
Capital stock by Tax Commission	37,581	53,031	47,286	47,229	62,564	65,717	55,791	61,748	70,814	76,011
Grand Total	$565,236	$692,498	$534,066	$569,794	$732,793	$849,654	$870,252	$984,021	$840,656	$751,703

The writer is indebted to Mr. Benjamin Draper and Miss Loretta Bell, of the staff of the Illinois Tax Commission, for the computation of these data.

[a] There was no formal equalization factor prior to 1931. Since 1931 the full value of personal property has been equalized at 37 per cent.

[b] The classification prior to 1933 has been converted into the 18-item classification prescribed by the Tax Commission in 1933.

[c] Valuation not listed separately.

[d] Capital stock locally assessed only.

[e] Not certified.

[f] Includes corrected figures from 1935-1936 Tax Commission reports.

[g] The County Clerk has included in his certified abstracts $400,000 in omitted property not included here.

[h] Includes office and store furniture not separately listed.

[i] Made up of many items that should be included under other classes of property. Beginning in 1933 an attempt at more accurate classification of assessments was begun.

[j] Includes household furniture not separately listed.

pensities of classification may, among other things, have caused few states to adopt such measures in the last few years.

California in 1929, after initial difficulties with fractional assessments and bank taxation in which the courts declared earlier legislation unconstitutional, adopted the present system of taxing solvent credits at 1 mill and stocks and bonds at 2 mills.[27] In that year Nebraska separated its intangibles into two groups, taxing money and things like money at 2½ mills, and other intangibles at 8 mills in contrast with the former 5-mill rate.[28] In 1933, Nebraska increased its rates on banks from 8 to 10 mills and on money from 2½ to 5 mills,[29] Kansas, which repealed its low-rate tax in 1930, re-enacted it with a 5-mill rate in 1931.[30] Florida and Ohio in 1931, Indiana and Arizona in 1933, Georgia in 1938, and North Carolina in 1939, enacted intangibles tax laws.[31] Beginning in 1935 Pennsyl-

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[27] *California Statutes*, 1929, p. 35. The 7 per cent law of 1925 (*Cal. Stats.*, 1925, p. 12) and the 1927 law taxing intangibles at 1.45 per cent of full value (*Cal. Stats.* 1927, p. 399) were declared unconstitutional *Arnold* v. *Hopkins*, 203 Cal. 553.

[28] *Laws of Nebraska*, 1929, p. 578.

[29] *Ibid.*, 1933, pp. 595, 597.

[30] *Kansas Laws*, 1931, pp. 440, 443.

[31] In Florida intangibles are taxed as follows:

Class A. All stocks of incorporated and unincorporated companies and all bonds except issues of Florida counties and municipalities and bonds exempt under Constitutions of Florida and U. S., taxed at 2 mills.

Class B. All notes, bonds, certificates of indebtedness, etc., secured by Florida real or personal estates, taxable at 2 mills.

Class C. All other intangibles taxable at one-tenth of one mill.

See *Laws of 1931*, Ch. 15789, pp. 1406–12.

Ohio systems of taxing intangibles described *supra*.

In Indiana all intangibles, with certain statutory exceptions, including bank stock, and shares in domestic corporations, are taxable at 2½ mills, collected by means of stamps. *Laws of 1933*, Ch. 81, pp. 523 ff. An excise tax of 2½ mills is imposed on capital stock, shares and surplus of building and loan associations. *Laws of 1933*, Ch. 82, pp. 541–44; a similar tax is imposed upon stock of banks and trust companies. *Ibid.*, Ch. 83, pp. 545–54.

The Arizona law (*Laws of Ariz.*, 1933, 1st Sp. Sess. Ch. 16) was declared

vania made substantial changes (effective in 1936) in its taxes on intangibles. In that year the state added a tax of one mill to the county tax, making the total rate on such property 5 mills.[32] In 1936, a state rate of 4 mills was applied (effective in 1937) to intangible personalty and corporate loans,[33] which rates were established for the future in 1937.[34] During the current year (1939) Michigan has revised its laws.[35] During the last decade few states, however, abandoned classification. Vermont repealed its intangibles tax law in 1931.[36] Maryland, one of the pioneer

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unconstitutional in 1933 (*State Tax Commission* v. *Shattuck*, (38 P. (2d) 631) and the refund of the taxes collected was authorized in 1935. (*Laws of Ariz.*, 1935, p. 4).

In North Carolina bank deposits are taxed at 1 mill; money on hand, in safe deposit boxes and on deposit with insurance companies, and net credits are taxed at 2½ mills; stocks are taxed at 3 mills; bonds, notes, etc., at 5 mills; beneficial interests in foreign trusts are taxed at rates applicable to types of intangibles here set forth. *Laws of 1939*, Ch. 158, pp. 355–69. Classification amendment adopted 1936. Special commission to draft legislation created, *Laws of 1937*, pp. 931–33.

In Georgia bank deposits are taxed at one-tenth of one mill; notes and obligations insured by FHA and specified mortgage loans for financing homes up to the value of $5000 taxed at 1½ mills; other intangibles taxed at 3 mills. *Georgia Laws*, 1937–38, p. 159.

[32] *Laws of Pennsylvania*, 1935, No. 182, pp. 414–29.

[33] *Ibid.*, 1936, No. 24, pp. 51–66 (Extraordinary Session).

[34] *Ibid.*, 1937, No. 171, pp. 633–52.

[35] In 1939, Michigan imposed a tax on intangibles to be effective January 1, 1940, as follows: income-producing intangibles taxable at 6 per cent on income-yield "but in no event less than one-tenth of 1 per cent nor more than three-tenths of 1 per cent of the face or par value of each item (or in the case of corporate stock or other evidence of corporate ownership having no par or face value, of the average per share contribution to capital, surplus and other funds in consideration of which all of the then outstanding shares of stock of the same class of such corporation shall have been issued)." Non-income yielding intangibles taxable at 1 per cent of face, par or contributed value. The value "of any item of property the value of which changes during the year shall be the average value to be computed under such rules and regulations as the [tax] commission shall adopt." If intangibles are owned only a portion of year taxes shall be proportionately reduced. *Laws of 1939*, Senate Enrolled Act No. 166, Sec. 2. After payment of costs of administration, proceeds of tax are divided ⅓ to state, ⅔ to counties and cities on population basis as shown by latest federal census. Sec. 6.

[36] *Laws of Vermont*, 1931, p. 17.

states in the low-rate taxation of intangibles, repealed its law as of January 1, 1940.[37] Meanwhile several states have adopted income taxes without repealing the low-rate taxes on intangibles.[38] Nevertheless the interest in classification is not so great as it was ten or twenty years ago.

Indeed, the problems of state and local taxation have changed since classification was championed as a major reform. In the early days classification vied with separation of sources of state and local revenue for favor. Progress in centralized administration has solved some of the problems. The development of state-collected and state-administered taxes has freed state governments from excessive dependence upon the property tax for revenues. This tendency for states to develop their own revenue systems has been going on for many years. Both classification and separation were being advocated before the extensive development of grants-in-aid and the sharing of state-collected taxes. Integration of revenues with division of tax receipts to subordinate units has taken the place of classification in popular discussion. This is far more fundamental to the solution of financial problems than classification. The tendency to develop systems of personal taxation more closely related to ability to pay is also a factor in the situation. It should also not be forgotten, that the right to adopt classification has become widely extended. Approximately 40 states can legally adopt some form of classification. In one form or another classification is found in these and a few other states. Thus, with the right to employ classification becom-

[37] As reported in a letter from the Chairman of State Tax Commission of Maryland, January 22, 1940.

[38] *Cf.* Ford, *op. cit.*, p. 71. States listed are California, Georgia, Iowa, Kansas, Kentucky, Louisiana, Maryland, Montana, North Carolina, South Dakota, Vermont, Virginia and West Virginia. For a more recent summary of legislation, see *Property Taxation of Intangibles*, National Association of Assessing Officers.

ing widespread it is natural that the movement to secure the classification privilege should abate.

Evaluation of Classification

The principal service of classification has not been as a fiscal measure to fill public treasuries but to provide greater justice and flexibility in the operation of the property tax. Its main contribution, too, has been in the field of constitutional reform. It has given legislatures greater freedom in the taxation of property and has demonstrated that, by and large, these assemblies can be trusted in adopting tax measures not to abuse seriously the privileges conferred upon them. To be sure, no one will approve of all of the classification measures which have been adopted, but the history of classification does demonstrate that legislatures will act with reasonable wisdom when given broad constitutional powers relative to taxation. And, if property is to be taxed the legislature should possess the right to classify property. The prudence of "wide-open" constitutional provisions concerning taxation has been repeatedly demonstrated.

Moreover, it would seem that classification may well find a place under a system of taxes *in personam.* Once the property tax was a tax designed to measure the capacity of the owner to contribute to the support of government. Soon the yardstick of capacity was forgotten and the tax became a levy upon things. Within the *ad rem* framework classification came to have a relation to capacity to pay; at least writers spoke as though it did. It was argued that some property could stand the impact of taxes better than other property. Differences between properties were translated into differences in capacities to pay. Within such a framework this sort of logic may *perhaps* be defended, but the measurement of taxable capacity is really a personal

matter. People, not things, bear the burdens of taxation. Just how taxable capacity is to be measured may be open to debate. Perhaps the capacity of individuals to pay taxes may be measured through a combination of income and wealth. If wealth is considered, doubtless all forms may not be counted alike or given equal weight in the computation. Just as funded and unfunded income are differentiated, so different types of wealth may be distinguished. The differentiation of unlike things is the essence of classification. Such differentiations are vastly broader than property taxation. They underlie the whole field of government support. If, however, the property tax should be converted into a net fortunes tax some use of the classification principle would seem to be in order.

In conclusion it may be said that the place of classification in the fiscal system depends on the components of the tax system. It may find a place among many taxes. It may not be utilized as to intangibles but to tax forests, or to extend preferences to buildings or homes, or in the severance of minerals, or in the taxation of household goods.[39] It may take other forms. Wherever classification makes its appearance it is presumably because the objects or sources of taxation are not alike, and the legislature desires to differentiate among them. Classification cannot be touted as a great revenue producer. Where it is advanced it must be because of the justice its application involves. It stands for an increased degree of constitutional freedom and the right of legislatures to experiment in the solution of property tax problems. In this course there is hope. Here classification performs its best service.

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[39] This is a possibility for the future, not an argument in favor of these practices, nor an implied condemnation of them.

CHAPTER VIII

PERSONAL PROPERTY TAXATION

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MANY observers have predicted that American property taxation would eventually rest exclusively upon real estate, upon which it has long very largely concentrated. Since ancient times attempts to collect a general tax at a uniform rate upon all types of property have been fruitful of common evasion of personal property, with the result that modern nations have almost universally shunned general property taxation and have contented themselves with applying property taxes to real property only. In the United States there has been at work for many decades a tendency for personal property to escape taxation by evasion and exemption, yet at times our state and local governments, as during the depression of the early 1930's, have exerted renewed efforts to expand their revenues from personal property taxation. Will the long-time tendency for personal property taxation to decline continue, or will the pressing revenue demands of the state and local governments halt its disintegration?

In attempting to answer this question we are confronted with a lack of data concerning the detailed trends in personal property taxation in our numerous local governments and among the states, but the available evidence in a num-

ber of states indicates an inclination to increase the exemptions in personal property taxation and a long-run tendency for the assessed value of personal property to decline relative to the assessed value of real estate. On the other hand, personal property assessments have shown an increase in a number of states since 1933 in relation to real estate assessments.

The Bureau of the Census has recently reported a decline in the assessed value of real estate, personal property, and other property in the period 1932–1937.[1] The valuation of personal property for state and local taxation constituted 18.7 per cent of the total valuation in 1932 but only 15.7 per cent in 1937, and the actual valuation of personal property declined in this period from $30,500,000,000 to $21,900,000,000. The drop in the valuation of real estate was relatively less and the ratio of the assessed value of real estate to the total valuation rose from 77.1 per cent in 1932 to 80.1 per cent in 1937. The data are summarized below:

ASSESSED VALUATION OF PROPERTY
(Dollar Figures in Billions)

	1932		1937	
Real estate	$125.9	77.1%	$111.3	80.1%
Personal property	30.5	18.7	21.9	15.7
Other property	6.9	4.2	5.8	4.2
Total	$163.3	100.0	$139.0	100.0

It is not known what the present collections from personal property taxation are in the United States, but the

[1] For an interpretation of the Census data see the bulletin of June 10, 1939, "Assessed Valuation of Property Subject to General and Selective Property Taxes by States: 1937."

total revenues from property taxes have apparently held up well and have perhaps increased since 1932. In that year, according to the Bureau of the Census, state and local general property tax receipts were approximately $4,685,-000,000. Property taxes supplied $4,500,000,000 in 1937, the Twentieth Century Fund has estimated, and $4,745,-000,000 in 1938, according to a Treasury estimate. The stability and possible increase in property tax revenues in recent years are probably to be traced to the flow of collections from taxes on real rather than on personal property, although some of the personal property taxes have recently produced increased revenues or have held their own in relation to real property taxes. The available data confirm the well known fact that personal property assessments are relatively small as compared with real estate assessments. Some observers believe, however, that the value of personal property actually exceeds that of real estate and is increasing in relation to it.

The base of personal property taxation has been greatly reduced by evasion and has also been nibbled away by increasing exemptions. During 1939 Delaware joined New York in extending exemption from taxation to all personal property, the District of Columbia and Michigan abolished the property taxation of intangibles, and new exemptions were given in other areas to encourage industrial developments. Yet, while household furnishings and personal effects and intangibles very commonly evade property taxation where they are not exempt, and the tendency continues to exempt them from property taxation, the general inclination appears to be the continued taxation of tangible personalty employed in business in conformity with both popular approval and the expert opinions of students of taxation.

Personal Property Assessments

It has not been possible to assemble data for all the states, but statistics may be presented for several states to show the trend in personal property assessments.

New York

The gradual disappearance of personal property from the assessors' lists in New York and its final exemption from property taxation in 1933 have been much publicized. The ratio of personal property to total property assessments rose from 18.9 per cent in 1840 to 25.5 per cent in 1860, but thereafter suffered a decline to 1.2 per cent in 1932.[2] To be sure, the state employs a capital stock tax and a tax on mortgages on real property, but personal property taxation in the ordinary sense has disappeared.

Massachusetts

The trend in Massachusetts has been a decline in the actual and relative valuation of the personal property reached in local taxation and a recent fall in personal property, as compared with real property, taxes. Some additional exemptions of personal property have occurred, as of domestic machinery in 1937, although renewed efforts are now being made to augment the collections from personal property taxation. The valuation of exempt personalty attained $33,000,000 in 1931 but decreased to $30,000,000 in 1937. The ratio of the valuation of exempt, to the valuation of taxable, real and personal property mounted from 16.0 per cent in 1925 to 20.5 per cent in 1935.[3]

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[2] *Report of the State Tax Commission*, 1937, pp. 149–150.

[3] The data cited here have been obtained in correspondence with the Department of Corporations and Taxation.

The total value of taxable property increased in Massachusetts from approximately $800,000,000 in 1861 to $7,250,000,000 in 1930, then decreased yearly to $6,300,000,000 in 1937. The assessed valuation of real estate followed this same trend, rising from about $600,000,000 in 1861 to $6,400,000,000 in 1930, and declining to $5,700,000,000 in 1937. The assessed value of personal property slowly advanced from $300,000,000 in 1861 to over $1,000,000,000 in 1912, remained at $1,000,000,000 or more for a number of years, declined after intangibles were exempted from property taxation in 1916, and increased to $1,000,000,000 in the 1920's. The general trend since 1929 has been downward, but after 1933 a rise in assessments occurred. The valuation in 1937 was nearly $600,000,000. The valuation of machinery has decreased since 1929, but the valuation of live stock and stock-in-trade has recently tended upward, and the valuation of other tangible personal property has risen since 1930. Intangibles, of course, are exempt from property taxation and are reached by the income tax.

The revenues from property taxation in Massachusetts have fluctuated between $200,000,000 and $240,000,000 in the period 1926–1935. They were rising until 1932, when they slumped but rose again to about $235,000,000 in 1935. The revenues from real estate followed the same general trend, increasing from approximately $178,000,000 in 1926 to a little over $200,000,000 in 1932, then falling and rising again to $200,000,000 in 1934 and 1935. Personal property tax revenues were approximately $30,000,000 yearly in the period 1926–1929. They dropped to $25,000,000 in 1930 and have since fluctuated near this figure. In summary, personal property tax revenues suffered an actual as well as a relative decline in the period 1926–1935, but since 1933 the value of exempt tangible personalty has shown a slight

general decline. The generous exemption of $1,000 in individual personal property still continues, however, and on the whole relatively little personal property is taxed in Massachusetts.

Connecticut

The assessed value of personal property in Connecticut increased from 1920 to 1930, after which it fell off as the depression deepened, falling from $361,000,000 in 1930 to $276,000,000 in 1933, then rising to $296,000,000 in 1935.[4] The assessed value of real estate rose steadily from $1,600,000,000 in 1920 to $2,819,000,000 in 1931, after which it dropped to $2,664,000,000 in 1935. The ratio of the assessed value of personalty to the assessed value of all property declined from 16.5 per cent in 1920 to 9.2 per cent in 1933, but increased a little to 10.1 per cent in 1935. The assessed value of cables, conduits, and pipes increased consistently after 1920 and represented 1.8 per cent of the total property valuation in 1935 as compared with 1.2 per cent in 1930 and 0.5 per cent in 1920. The assessed value of farm animals and the stocks of manufacturers and merchants decreased after 1920, both in dollars and relatively, while the assessed value of household furnishings and of motor vehicles increased in dollars and in relation to the total property valuation until 1930, declined during the depression, and subsequently rose again. In 1935 the valuation of household furnishings was $28,000,000 and that of motor vehicles $67,000,000 as compared with valuations of $24,000,000 and $97,000,000 respectively in 1930. Considering the whole picture in Connecticut between 1930 and

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[4] The data are from the Tax Commissioner's reports, *Information Relative to the Assessment and Collection of Taxes*. Public utility property is excluded.

1935, the valuation of personal property declined in amount and relative importance but small gains were experienced in 1934 and 1935.

New Jersey

A somewhat similar story may be related concerning personal property assessments in New Jersey. The assessed value of personal property rose from $641,000,000 in 1923 to $779,000,000 in 1927, fell to $594,000,000 in 1934, and moved back to $748,000,000 in 1939.[5] At the same time the assessed value of real estate advanced to $5,532,000,000 in 1930 from $3,303,000,000 in 1923, but dropped steadily to $4,740,000,000 in 1939. Personal property assessments decreased relative to real estate assessments during the 1920's, then increased after 1934.

A recent investigating commission in New Jersey declared that the personal property in the state had a value of $12,000,000,000 but was assessed at only $677,000,000, while the full value of real estate was $5,500,000,000 and the assessed value was $5,000,000,000. The real estate tax was $227,000,000, yet the personal property tax was merely $30,000,000, or 11.6 per cent of the total property levy, including the taxes of public utility and insurance companies. The commission recommended the state administration of all personal property taxation, the exemption from property taxation of household furnishings and personal effects because of the assessment difficulties, and the exemption of intangible property up to a valuation of $10,000 when not employed in business. It was suggested that intangibles used in business other than retailing should be exempt from property taxation and be subjected to a capital stock tax,

[5] The data were supplied by the State Tax Department.

and that all tangible and intangible property in retailing should be freed from property taxation and a state gross receipts tax at a rate of 3 per cent be utilized instead.[6]

Michigan

Personal property assessments in Michigan advanced from $311,000,000 in 1900 to $1,504,000,000 in 1930, suffered a slump during the depression, then climbed upward to $1,183,000,000 in 1938.[7] The ratio of personal property to total property assessments slowly fell from 23.6 per cent in 1900 to 15.8 per cent in 1933, when the trend was reversed and the ratio rose to 19.6 per cent in 1938. The improved assessment of personal property in Michigan after 1933 is noteworthy, but a similar trend has been observed in other states as well. The exemption of intangibles from property taxation in 1939, however, removes one type of personalty from the tax rolls.

Minnesota

The states thus far cited, with the exception of New York and Connecticut, employ general property taxes. Minnesota, with a classified property tax, suffered a downward movement of personal property assessments, excluding money and credits, from $272,000,000 in 1929 to $196,000,000 in 1934, and later an upward movement to $217,000,000 in 1938. In the period 1928–1938, the full value of real estate continued to decline, falling from $4,527,000,000 in 1928 to $3,378,000,000 in 1938. The full valuation of personalty was $875,000,000 or 15.0 per cent of the total

[6] *Report of the New Jersey Commission on Tax Law Revision,* Part I, "Taxation of Real and Personal Property," 1939.

[7] From State Tax Commission and State Board of Assessors, *Report* for 1937–1938, p. 35.

property valuation in 1928 and $738,000,000 or 15.4 per cent in 1938, after a dip to $664,000,000 or 14.0 per cent in 1934. The valuation of money and credits, it should be emphasized, rose from $417,000,000 in 1928, or 7.2 per cent of the total valuation, to $684,000,000 in 1938, or 14.3 per cent. The valuation of real estate, relative to the total, fell without serious halting from 77.8 per cent in 1928 to 70.4 per cent in 1938.[8] Gains have thus been accomplished in Minnesota in the assessment of personalty since 1932, although personal property is taxed at lower rates than real estate and its total valuation is far less than that of real estate.

Wisconsin

Personal property taxation in Wisconsin has tended, over a long period, to decline, but since 1933 increases in assessments are reported, both in dollars and in relation to realty assessments.[9] The valuation of personalty attained a maximum of $1,000,000,000 in 1920, rising from $250,000,000 in 1900, but toppled to the low level of $333,000,000 in 1933. A valuation of $488,000,000 was gained in 1938, but in 1939 the valuation dropped back to $456,000,000. The valuation of real estate, however, remained around $4,000,000,000 during the 1930's, after climbing to $6,000,000,000 in 1929. A decline was experienced in 1939.

The ratio of personalty assessments to the total property valuation marched upward from 17.4 per cent in 1901 to 25.1 per cent in 1911, in Wisconsin, but a continuous decline followed until 1933, when the ratio was 7.8 per cent. The ratio rose to 11.0 per cent in 1937 and again fell off in 1938 and 1939 and was 10.4 per cent in the latter year.

[8] From Minnesota Tax Commission, *Biennial Reports.*

[9] Data have been obtained from the State Tax Commission.

The most recent trend in Wisconsin is thus the further decline of personalty assessments, after some improvements after 1933. Exemptions since 1911 have cut off substantial sums of property from the tax rolls. When the income tax was adopted in 1911, money and credits were exempt from property taxation, and in the same year watches, pianos, organs, and bicycles were also exempted. Locally assessed bank stock was exempted in 1926, and in 1931 automobiles, horses, mules, wagons, carriages, and sleighs were added to the other exemptions. Personal consumption goods are practically exempt and the property tax rests very largely upon business personalty.

Oklahoma

In Oklahoma, where the state general property tax was abolished in 1933, the assessed value of personalty decreased from $328,000,000 in 1930 to $169,000,000 in 1933, but rose thereafter and was $183,000,000 in 1938. The valuation of real estate and public utility property also declined, but at a slower rate. The ratio of personalty assessments to total property assessments, including public utilities, dropped from 17.7 per cent in 1930 to 13.7 per cent in 1933, subsequently rising to 14.9 per cent in 1938. With the help of the homestead exemption, the valuation of real estate, which was 63.7 per cent of the total in 1930 and 60.7 per cent in 1934, was 61.5 per cent in 1938. The most recent trend in Oklahoma is toward a greater importance of personal property valuations, following the decline early in the 1930's. No pronounced tendency is evident in the extension of personal property tax exemptions.[10]

[10] From Oklahoma Tax Commission, *Third Biennial Report*, 1936–1938, pp. 188–190, and data furnished by the Tax Commission.

Oregon

Since 1920 the assessed value of personal property in Oregon and its ratio to total property assessments have tended to decline, but an upward movement has been noted since 1933.[11] The assessed value of personalty increased from $122,500,000 in 1910 to $160,000,000 in 1919, with intermittent reverses, then fell off to a low of $71,000,000 in 1933, but managed to rise again to $84,000,000 in 1937. The ratio of the personal to the total property valuation rose from 14.5 per cent in 1910 to a high of 16.2 per cent in 1919, steadily fell to 7.4 per cent in 1933, and moved upward again to 9.4 per cent in 1937. The period 1910–1937 was marked by a small relative decline of real property assessments and a material decline in personalty but toward the end of the period absolute and relative gains in personalty assessments were reported. Personal property tax exemptions, as in other states, have increased. Household furnishings were exempt in 1913, automobiles in 1919, and intangibles in 1932, but automobiles and intangibles are subject to other forms of taxation.

Growing Exemptions

It is not possible here to present a complete account of the decline of personal property assessments in the period after 1900, but in many states valuations were declining relative to total property assessments and perhaps also in amount. Since 1933, however, personalty assessments have staged a comeback in a number of the states, at least temporarily reversing the downward trend. The evasion of

[11] Bureau of Municipal Research and Service, University of Oregon, *Trend of Assessed Value of Taxable Property in Oregon by Classes of Property,* 1910–1937, 1938.

personal property was probably increasing before 1930, although the relative amount of evasion throughout the country is not known. The base of personal property taxation has been further reduced by exemptions, but the exemptions have increased at a faster rate in some states than in others, the exemptions are more likely to apply to household furnishings, personal effects, intangibles, and automobiles than to personalty employed in business, and some of the states report at least a temporary lull in the extension of exemptions. The greater efforts after 1930 to obtain revenues have resulted in considerable improvement in personal property assessments in a number of states, but on the other hand exemptions have also grown somewhat during the 1930's.

The trends in personal property tax exemptions have recently been surveyed by the National Association of Assessing Officers.[12] Intangibles are virtually exempt from all property taxation in 10 states and, at the opposite extreme, are liable for the general property tax in 9 states. Low-rate intangibles taxes are employed in 18 states and income taxes are resorted to in 11 states. Many tax authorities have urged that intangibles should be taxed on their income and not on their value, and with the spread of income taxation there is a tendency in this direction. Where an income tax is not imposed, a low-rate intangibles tax is generally favored. The prevalent evasion of property taxes on intangibles, their unpopularity with taxpayers, their administrative difficulties, and the small property taxes usually collected from intangibles have encouraged their exemption and the resort to income taxation. On the other

[12] *Property Taxation of Intangibles,* Bulletin 21, 1939, *Exemption and Preferential Treatment of Factories,* Bulletin 24, 1939, *Exemption of Household Furnishings from Property Taxation,* Bulletin 12, 1938, and *Property Taxation of Motor Vehicles,* Bulletin 17, 1938.

hand, some states report increased assessments for the intangibles property taxes recently, and other states, as Pennsylvania, have turned to intangibles property taxes for greater revenues.

Household furnishings and personal effects have rarely, if ever, been assessed with any great success. They are not uniform in their characteristics, are often mobile, and are very commonly not reported for taxation. Evasion receives the blessings of the assessors, who do not wish to pry into the secrets of the household and who also have an aversion to becoming unpopular among the taxpayers who elect them to office. The administrative problems of taxes upon this property are grave and numerous and only small revenues can be obtained. There is more and more a tendency to recognize the facts of evasion and legally to exempt household furnishings and personal effects from property taxation. It is argued that this property is of a consumptive, rather than a productive, character, although this is more of an excuse than a justification for exemption. Consumption goods are liable for various specific and general sales taxes and are taxed by governments hungry for revenue when they find it feasible to tax them. But property taxes on these commodities are impracticable, as tax students have long recognized, and efforts to enforce such taxes should be abandoned.

In 9 states this personal property is fully exempt while in 9 states it is, in theory, fully taxable. Generally the exemption of a certain amount of household furnishings and personal effects is authorized. A limited exemption, ranging from $50 to $1,000, is found in 22 states and the District of Columbia and is applicable to household furnishings. Several states grant a lump-sum exemption of $100 to $1,000 on all classes of household furnishings and per-

sonal effects. New Mexico allows the same lump-sum exemption for personalty and real estate and many states permit such an exemption to war veterans and blind persons. Since personal property is ordinarily greatly undervalued when it is assessed, the actual exemption will tend to be much larger than the amount the law specifies. The taxes which the statutes may impose are very commonly evaded so that little revenue actually results, and relatively less revenue will probably be procured in the future because there is little inclination to enforce property taxes upon household furnishings and personal effects and also because exemptions are slowly increasing. Moreover, the tendency to impose state sales taxes upon personal property permits revenue to be obtained indirectly from consumptive goods which could not be obtained directly.

The exemption of motor vehicles from property taxation has been adopted in 17 states but exemptions are not now increasing with any rapidity. In another state, Louisiana, motor vehicles are exempt from state and county property taxes but may be taxed by municipalities. In 8 states special personal property taxes, locally assessed and at a uniform state-wide rate, are collected. The special property taxes have recently tended to become more popular, although 15 states still tax motor vehicles under the general property tax.

The revenues obtained from the personal property taxes upon automobiles have been relatively small and have apparently tended to decline in late years. Local automobile taxes, consisting almost entirely of personal property taxes, increased slowly from $60,000,000 in 1924 to $73,000,000 in 1935 then subsequently declined to $72,000,000 in 1938.[13]

[13] Automobile Manufacturers' Association, *Automobile Facts and Figures*, 1939, p. 22. Also see p. 4 for statistics of automobile registrations.

Data are not available to show the assessed valuations of automobiles, but the number of units in use increased faster than the retail prices of passenger cars in the period 1925–1938, and the total value of motor vehicles presumably advanced. It is of interest that the state registration charges grew from $225,000,000 in 1924 to $390,000,000 in 1938, and have greatly overshadowed the less productive personal property taxes. The fact that a considerable number of states exempt motor vehicles from property taxation because they regard the registration charges in themselves as adequate suggests that possibly the personal property taxes will be abandoned eventually, although the states are not hastening in this direction.

The taxation of personal property employed in business has generally been defended by tax authorities and will apparently continue as the customary policy, yet some additional exemptions of both real and personal property have recently been adopted. The exemption of personal property in business was practiced in colonial times and has always found a certain amount of favor among those who wish to encourage industrial expansion or the transfer of industries from one locality to another. Since 1900, with the advance of industry in the South and the West, exemptions have increased. In 4 states all or particular types of personalty in industry are permanently exempt. In the states where no state general property tax is imposed, exemption of all tangible personalty from state taxation occurs. Three of the states with comprehensive classified property taxes have given preferential tax rates to the personal property of manufacturers. Several states permit so-called temporary exemptions, usually for 5 or 10 years, to personal property employed in particular industries, as in textiles or metal goods. The temporary exemption may be given to both

real and personal property. A few states exempt the grain handled by elevators, mills, and warehouses. In only 26 states are no special exemptions allowed from property taxation.

Farmers have been given preferential treatment by the exemption of all farm produce in a fourth of the states. They may also be granted limited exemptions of a certain amount of farm machinery, perhaps $500 or $1,000, but this may be large enough, with prevalent underassessment, to cover practically all of the farm machines. Merchants appear to have fared less fortunately with exemptions than the manufacturers and farmers and are usually liable for the full rate of the general or the particular rate of the classified property tax, but much evasion and undervaluation of merchants' inventories and other personal property occurs. Occasionally, as in Michigan, a general minimum exemption of business personalty may be granted, although the exemptions of personal property are quite universally extended to particular industries, as to agriculture, horticulture, or the raising of young livestock, and are usually of a temporary nature.

Conclusions

Personal property taxation was, in general, apparently suffering a long-time decline before the depression of the early 1930's, but the trends in valuations and tax collections were not uniform and varied from state to state. While the evasion of personal property taxation is an inherent obstacle to its use for large revenues, the more strenuous efforts in a number of the states after 1933 and the recent administrative improvements have brought at least a temporary revival of some of the lost importance of personal property taxation. On the other hand, two states,

New York and Delaware, have gone so far as to exempt all personal property from property taxation, others have removed the property tax from intangibles, and a considerable number of the states grant substantial exemptions to household furnishings, automobiles, and tangible personalty employed in particular industries. In the states where the general property tax has been turned over to the local governments, as in Vermont, or property other than intangibles, as in Pennsylvania, very little tangible personal property may actually be assessed and little if any more may be assessed in the other states because of evasion as well as exemption.

The exemption of household furnishings and personal effects from property taxation has the approval of many taxation authorities and is tending to increase, although the wholesale evasion of such property may render exemption little more than a legal sanction of the existing condition of affairs. A tendency exists for intangibles to be removed from the property tax and to be brought under the income tax, but this trend has not yet gone very far and is operating slowly. There appears, however, to be lacking a well-defined agreement among tax students that automobiles should be exempt from property taxation, although the widespread use of registration charges and the more common collection of sales taxes on motor vehicles are tending to cause the abandonment of property taxation for other taxes. Tangible business personalty is generally liable for property taxation and no strong movement is now on foot for its exemption, except in special cases.

The common evasion and growing exemption of personal property from property taxation may, in time, cause its complete abandonment in the United States, but that day is apparently not near. Rather, the base of the personal property taxation is slowly being eaten away by the ravages

of the times, and certain elements of this form of taxation, as that resting upon tangible business personalty, may long remain. Temporarily, at least, personal property assessments have shown new vigor and some increases in assessments are being reported. The long-time tendency of personal property taxation to decline is thus being halted, momentarily at least, in certain states, yet it seems reasonable to believe that household goods of various types will eventually disappear completely from the assessors' rolls by evasion if not by exemption, that intangible property taxes will be given up increasingly for income taxes, and that personal property taxes may be removed from motor vehicles as other forms of taxation are extended. While tangible business personalty may at length follow the path of exemption, the outlook, in general, is apparently for continued taxation, although the admonitions of economists that exemptions to foster industrial expansion are socially unsound are frequently disregarded.

CHAPTER IX

THE CASE FOR LOW-RATE TAXATION OF IMPROVEMENTS

HAROLD S. BUTTENHEIM

Editor, The American City

AN OFT-QUOTED paragraph from the 1937 report of the National Resources Committee—now the National Resources Planning Board—on *Our Cities: Their Role in the National Economy* recommends that:

> State and local authorities should consider the reduction of the rate of taxation on buildings and the corresponding increase of such rates on land, in order to lower the tax burden on home owners and the occupants of low-rent houses, and to stimulate rehabilitation of blighted areas and slums.

For our present discussion of this proposal, two questions suggest themselves: How sound is the principle? How practicable is its adoption?

That the bulk of all revenues of municipal and county governments in the United States is raised from real estate taxation is a matter of common knowledge and belief.

Nobody knows the exact proportion because of the fact that tax receipts from real and personal property are usually lumped together in official reports. According to a recent study,[1] property taxes in 1939 yielded 94 per cent of locally-collected tax revenues, 5 per cent of state-collected

[1] Tax Policy League, *Tax Yields: 1939.*

revenues, and 35.6 per cent of total tax collections for all units of government in the United States. It is not known just how large a portion of these percentages represents personal property tax collections. Personal property assessments amounted to over 15 per cent of all property assessments in 1937.[2] If the ratio of real and personal property in 1939 was similar, it would appear that real estate taxes accounted for approximately 30 per cent of the total tax burden in 1939. Variations in a number of states in rates and methods of taxing various classes of property, however, will probably affect this ratio to some extent.

Real property in 1937 was assessed at $111,306,545,000; personal property, $21,948,040,000; and other property, $5,751,159,000. "Other property" consists largely of public utility assessments in 28 states in which this type of property is not separately classified as between real and personal property.

The assessed valuation did not necessarily represent the true or full value of real and personal property, as the basis of assessment of property varies markedly in the different states and in different sections of the same state.

Per capita assessed valuation ranged from $1,933, in Rhode Island, to $195, in South Carolina. These figures are exclusive of the District of Columbia, having a per capita assessed valuation of $2,858. The per capita figures were, of course, affected by the varying extent to which personalty was assessed for taxes and the deviation in the ratio of assessed to true valuation of both realty and personalty in the states.[3]

In 4 states it was impossible to obtain a division of the

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[2] U. S. Bureau of the Census, *Assessed Valuation of Property Subject to General and Selective Property Taxes by States: 1937.*
[3] *Ibid.*

total assessed valuation between real and personal property, and the figure for real property includes both classes. In so many of the states were no data available as to how the real property assessments were divided between land and buildings that no attempt was made by the Bureau of the Census to give this breakdown in the report—highly important though such differentiation would be for a rational readjustment of the real estate tax.

Real Estate's Share of Local Revenues

So much for the lack of definite knowledge. As an example of highly erroneous belief regarding the tax burden on real estate, the city of New York may be cited. It is commonly stated that real estate supplies some 75 or 80 per cent of New York City's revenues. The Taxation Committee of the Citizens' Housing Council of New York has pointed out, however, in a recent report on "Local Taxation and Housing," that:

> In such computations the general tax account and the general fund receipts are considered as total revenues, *e. g.*, in 1937 these two sources produced $568,610,178, of which the real estate tax represented 80 per cent. This computation is incorrect because the city's total income, exclusive of all borrowing, was $840,869,070, of which real estate taxes represented 54.14 per cent. This latter total includes such sources of income as emergency relief taxes, state aid and federal grants.

A decreasing burden on general property taxes in favor of other revenues, especially subsidies and grants from superior units of government, was one of the findings of a tax-rate survey for 1933–1939 of 272 American cities and 15 Canadian cities, by Rosina Mohaupt of the Detroit Bureau of Governmental Research, reported in detail in the *National Municipal Review* for December, 1939.

But whether or not, in any given community, real estate

as a whole is overtaxed, it is certain that some real estate contributes more and some less than its just share of public revenues. The roots of this injustice are to be found not only in our too prevalent carelessness or favoritism in property assessment, but more fundamentally in our general failure to differentiate between land and improvements as bases for taxation.

This is not the place for a discussion of the ethical soundness and political expediency of basing taxation on *ability to pay* as contrasted with *benefits received.* Most thinking on the subject is rationalized, I believe, by personal predilections. My preference happens to be for a revenue system which aims at a fair balance between these two methods of determining the incidence of taxation—with a strong leaning towards the *benefit* theory in the raising of local revenues, and restriction of *ability* taxes in the main to the national and state governments. Application of the ability theory to municipal or county taxes would be hindered by the ability of taxpayers to escape from one local jurisdiction to another.

But the one source of taxation that cannot migrate is the land. A building, once it is erected, cannot readily escape—but an unwise system of property taxation can impose a detrimental degree of birth control on new buildings and encourage longevity of decrepit structures beyond their useful span of life.

The Graded Tax Plan as a Stimulus to Construction

Regardless of its ownership and of the taxes resting upon it, any given site would be exactly where it now is; but the use to which that site is put is affected, much more than is generally realized, by how the realty tax is divided be-

tween land and improvements. The case for the graded tax plan—a lower rate of taxation on improvements than on site values—was succinctly stated in a letter addressed on November 16, 1938, by William J. Schieffelin, as chairman of the Citizens' Union of New York, to a number of civic organizations interested in the local housing problem:

> The housing problem in New York and elsewhere will never be adequately and justly solved, in the opinion of the Citizens' Union executive committee, until a rational system of taxation replaces our present method of penalizing progress.
>
> If it were proposed to revive the ancient English exaction of special levies on windows and chimneys, the folly of handicapping housing in this way should be plain to all. But in New York, as in American cities generally, taxes are levied not merely on windows and chimneys, but on the entire dwelling. The result, not generally recognized, is to make housing much more costly to own or rent than it need be.
>
> The other element in urban real estate—building sites—involves excessive costs to the developer or home owner for just the opposite reason. The lower the percentage of ground rent which taxes absorb, the higher land prices become. If more of the ground rent were taken in taxes for services rendered by the community, the value of land for use would be maintained, but the cost to the buyer would be lessened. This would greatly stimulate house building, and improvement and real estate and construction activities generally.
>
> For these reasons we believe that our system of real estate taxation ought to be modified over a period of years, so that a steadily increasing amount of the tax would be transferred from improvement values to site values. Such a shift, under a graded tax plan, would lessen the burden on all owners whose dwellings or other structures are assessed at more than the sites on which they stand. Owners of substandard buildings or vacant land would be given a much-needed spur to property improvement, and the shelter of a large percentage of New York's ill-housed millions would be bettered without resort to costly subsidy.
>
> During the last twenty years the city of New York has experimented with three methods of stimulating construction or rehabilitation by partial tax exemption. In each case the results have proved beneficial to special groups. Why not make the benefits general? Why not recast our entire real estate tax system so as gradually to free buildings and improvements of all kinds from future taxation, thus giving private

initiative a better opportunity than it has ever had to provide adequate housing without special subsidy?

Burdens and Benefits

The proposal that site values or ground rents be made the sole or chief basis of real estate taxation is sometimes met with opposition from diametrically opposite sources. At the one extreme it is alleged that the burden on the land will be so great that no one will want to own or develop real property. At the other extreme we are told that, in order to pay the tax, the pressure to build will be so great that an orgy of over-development and land-overcrowding will result.

Let it be frankly admitted that the reform proposed would adversely affect a minority of landowners *as such.* No great forward step in advancing the public welfare can be taken without temporary hardship to some who are unable or unwilling to march with the procession. But the sufferers in the main would be those who are holding land out of use for speculative profits or whose "improvements" are substandard and thus worth less than the sites on which they stand. But some of these property owners could readily profit by modernizing their structures with freedom from the increase in taxes that would be incurred under the present system; and as members of the community, usually having other business or professional interests, such landowners would profit by the general rise in the level and stability of prosperity that a rational system of taxation would advance. Owners of small homes and, in general, all others whose improvement assessments exceed their site-value assessments would benefit immediately, since for them the decrease in taxes on improvements would exceed the increase in taxes on the land.

That a high tax rate on site values coupled with a low rate on improvements would tend to stimulate building construction and modernization is conceded both by advocates and by opponents of the graded tax plan. Those favoring the idea proclaim this stimulus to construction as its chief merit. They see in it an aid towards solving the housing problem and banishing unemployment in the building trades. The point of view of opponents of the plan, who are fearful not of the *under*-building of our cities but of their *over*-development, was set forth in the 1916 report of the Committee on Taxation of the City of New York, in the rebuttal by the negative:

> The results (of untaxing of buildings) will be, without any doubt, that all vacant land, so far as there is any, will tend to be covered with buildings, and that there will also be a tendency to replace all low two- or three-story structures by skyscrapers in the business districts, and by lofty tenements in the slums . . . The congestion per acre would be enormously increased and all the dangers to life and safety which would be removed in one way would be reintroduced in another.

The Committee, in its majority report, gave the obvious answer to this rather fantastic allegation by pointing out the power and duty of the city to prevent excessive density of land use:

> We think that it has been clearly proved that the tendency of the scheme would be to a more intensive use of land and that, therefore, it would be out of the question to adopt the scheme without first enacting laws to regulate the height of buildings and to provide for a proper zoning system.

In the city of the future the zoning power and the taxing power will, in my opinion, unite for the encouragement of rational urban development. Zoning will so control building heights and public and private open spaces that the

public interest would be served by the gradual development of the city up to the legal maximum thus permitted; the tax system simultaneously providing the stimulus to such development.

English Municipalities Demand Taxation Reform

The governing body of England's metropolis, the London County Council, has for some years been endeavoring to secure permission from Parliament to raise a larger share of London's revenues than at present from land-value taxation. A report adopted by the Council in July, 1936, concluded with the recommendation:

> That the Council is of opinion that the present system is inequitable in its incidence, that site value is a subject peculiarly suited to local taxation by reason of its arising from community influences including local expenditure and that it is accordingly desirable that the present burden of local expenditure should be transferred either wholly or in part from rates to a rate on site values. That His Majesty's Government be informed of the opinion expressed in the foregoing resolution and be urged to introduce legislation at an early date to empower local authorities to levy a rate on site values.

No action having been taken by the national government on this recommendation, the London County Council introduced its own bill in Parliament in 1938, providing for a start in site-value taxation with a rate of two shillings in the pound of *annual* land value. Reporting the defeat of this measure, A. W. Madsen of London, Secretary of the International Union for Land Value Taxation and Free Trade, adds:

> In spite of this, local authorities have not ceased to demand powers to rate land values, and in the last few weeks two of the largest county councils, Middlesex and Essex, have passed resolutions in that sense. And undismayed by the fate of the London County Council Bill, the Edmonton Town Council has reaffirmed its demand for the rating of

land values and sent its resolution to all the local authorities in the country, as quite recently the Tottenham Town Council did within the county of Middlesex. More than 240 local authorities have in the last few years declared for the policy. These things are evidence that the public demand for the taxation of land values is . . . only waiting upon a progressive Parliament to give effect to it.

The report just quoted was prepared by Mr. Madsen for the Henry George Centenary held in New York in September, 1939. At the same meeting delegates from Western Canada, Denmark, South Africa, Australia, New Zealand, and other parts of the world reported favorably on the results of varying degrees of site-value taxation in their respective countries.

Australia and New Zealand

Especially comprehensive was the report on "The Taxing and Rating of Land Values in Australia," by E. J. Cragie, M.P. In his concluding paragraphs Mr. Cragie said:

> Within the Commonwealth of Australia . . . approximately £15,000,000 of revenue is annually collected from the unimproved value of land by federal, state and local governments, and as rentals received by the Crown from leased lands.
>
> Wherever the principle has been applied it has given satisfaction. The assertion made by opponents of land values rating that its adoption would tend to overcrowding of houses, owing to the desire of the landholders to secure a big income from the site, has been shown to be without foundation. As a matter of fact, in municipalities which have adopted the land value principle it will be found that the land surrounding the house is of a bigger area than was granted under the old annual value system of rating. This is what might have been expected. With improvements exempted from taxation owners were encouraged to erect a better type of building, and it would be a foolish action on their part to spoil the appearance of a fine property by placing it on a small area of land.

In more than half of New Zealand's local authorities (169 counties, boroughs and town districts out of a total

of 316) real estate taxes are levied wholly on the basis of the unimproved site value. It is significant that this has come about, not by compulsion from the national government, but by local option. In a report on the subject for the Henry George Centenary, G. M. Fowlds explained that in 1896 a measure was passed enabling local authorities to raise part of their revenues by means of a rate on the value of land; that this did not apply to the revenues required for water supply, sewerage and certain other services, and that these limitations were not swept away until 1911. Under this law rates must be levied upon the value of land and improvements unless a poll of the ratepayers is taken and a majority vote in favor of rating on unimproved values. The adoption of this system is therefore in every case the deliberate choice of a majority of those liable to pay local taxes. After a period of three years a poll may be taken to revert to the old system, but in very few cases has such a poll been adverse to the unimproved value system.

Some years ago the British Government circularized all the Dominions asking for information on the operation of land values taxation and rating. From New Zealand, says Mr. Fowlds, the official reports were most favorable, and they appeared in the Blue Book published at the time in London. The New Zealand Commissioner of Taxes said in his report:

> The effect has certainly been to greatly stimulate the building trade. It has been the direct cause of valuable suburban land being cut up and placed on the market. The tendency of this system of taxation is not to increase the rent, but on the contrary, as the tax becomes heavier, it tends to bring into beneficial occupation land not being put to its best use.

A little earlier, replying to an American investigator of social legislation, then visiting the country, the late Rt. Hon. R. J. Seddon, Liberal Premier for thirteen years, said:

. The land tax as imposed in New Zealand, has been a fiscal success, and there can be no doubt that it has been a factor in bringing about our prosperity. The rating on the unimproved values for local purposes has proved a success and the opinion of the Government is that it should be made compulsory.

A few years after Mr. Seddon's untimely death in 1906, a Swedish economist, Mr. Johan Hansson, after a visit to New Zealand, published a booklet in which he gave some impressive figures in regard to the incidence of land value rating. He found that the population of the towns which had adopted rating on land values had increased by 29 per cent, while the population of the towns rating on the old system had increased by only 15.5 per cent; that the value of the improvements in the former towns had increased by 82.3 per cent as compared with only 36 per cent in the latter; and that the land values in the towns where land value was exclusively rated had increased by 105.2 per cent, as against an increase of only 51.9 per cent in land values in the towns under the old system of rating.[4]

Canadian Experiments

Thirty years ago a large number of municipalities in Western Canada, when the great western land boom was at its height, decided to exempt buildings from taxation and to increase the rate on land values. Their experience indicates that this timing was a mistake. The new system should have been introduced earlier, before the boom started, as it was in Australia and New Zealand.

The rush of population into Western Canada, during the first decade of the century, was so great that land values, at times, doubled over night. These increases in values

[4] G. M. Fowlds, *Land Value Taxation in New Zealand.*

amounted, in a few years, to scores of millions of dollars. It was hoped that the new method of taxation would serve to place a check upon the orgy of land speculation that was in progress. But by that time the boom had got out of hand. With land values rapidly doubling, trebling and quadrupling, it was soon found that the incidence of a tax for municipal purposes only did not provide an adequate check, and would not as long as the boom lasted. Scores of thousands of people in Eastern Canada, the United States and even in Europe bought western land, without seeing it and with no intention of ever using it. Their one thought was to make a profit through its sale.

Municipalities lost their collective heads. Anticipating that the great growth in population then taking place would continue indefinitely, they extended their borders, constructed water systems, built schools and laid pavements on a basis which anticipated future populations several times their then size—populations that never materialized.

The boom commenced to collapse shortly before the opening of the great war in 1914. The war finished it. Then the incidence of the tax made itself felt. Speculators, in increasing numbers, surrendered their holdings. Municipalities found themselves with large areas of vacant land on their hands from which they could not obtain revenue. Municipalities on all sides found themselves facing bankruptcy.[5]

The Government of Saskatchewan in 1917, and the Government of British Columbia in 1918, during the height of the World War depression, engaged Professor Robert Murray Haig of Columbia University, New York, to investigate and report upon the financial position of their municipali-

[5] The information relating to Western Canada's experience was received from Mr. H. Bronson Cowan of Peterborough, Ontario.

ties as well as the effects of the new system of taxation. Professor Haig, in view of the conditions then prevailing, reported that he considered it desirable that a tax should be reimposed upon improvements, at least temporarily. In his report to the Saskatchewan Government he said:

In considering a plan for readjusting the financial systems of the municipalities of Saskatchewan it should always be kept in mind that the present adverse conditions are abnormal. The war itself is in large measure responsible, for although the depression was already present before the war began, it has been more lasting and severe in some of its effects because of it. The revival of prosperity which everyone expects after the war should of itself bring an adequate solution of the present financial problem, and in all probability it will be possible to return to the system which was so popular in the past but which is so inadequate at present.

Speaking before the National Tax Association, at Atlanta, Georgia, in 1917, Professor Haig stated:

It should be carefully noted that nothing which has been said affects the attractiveness of the policy of exempting improvements during periods of prosperity. Conditions in Western Canada are at present admittedly abnormal. Indeed, there is every reason both from the economic and ethical points of view why the advantage gained through the assertion of the public's claim to a large portion of the ground rent should be preserved.

In a recent conversation, as reported by Mr. Cowan, Professor Haig repeated his opinion that the taxation of site values had not been given a full or adequate test in Western Canada. The fact that cities, both large and small, in Australia and New Zealand, had tested it for a much longer period, and during boom and depression eras, he said, he considered to be a matter of far-reaching importance. This was all the more the case in view of the de-

pressed condition of the building industries on this continent and the financial position of so many municipalities under our system of taxation.

Western Canada even today, nearly a quarter-century later, has not fully recovered from that boom period. Over large areas land values are still falling. The total value of taxable land of 32 cities, in British Columbia, not including Vancouver, in 1923, previous to which there had been an enormous shrinkage in values, was $85,360,840. In 1938 the total assessed value of this land was $71,294,743. These cities, however, had so much abandoned and other non-taxable land on their hands, the value of the taxable land was only $47,339,143.

Until 1924 a provincial law in British Columbia prohibited municipalities, other than Vancouver and village municipalities, from taxing land values more than 15 mills. In 1924 the limit was raised to 20 mills and in 1936 to 35 mills. This limitation forced many municipalities, which otherwise might not have done so, to revert to taxing improvements.

Cities and districts in British Columbia are free to tax improvements up to 75 per cent of the assessed value, and villages up to 50 per cent. Of the cities, in 1938, two *exempted* improvements 100 per cent, two 90 per cent and one 80 per cent, three 75 per cent, two 70 per cent, two 66⅔ per cent, two 65 per cent, seventeen 50 per cent, one 55 per cent and one 35 per cent. Out of 80 municipalities, including 33 cities, 28 districts and 19 villages, not one exempted improvements less than 35 per cent and 77 exempted them 50 to 100 per cent. Vancouver exempts improvements 50 per cent.

New Westminster, population 20,000, is one of the cities

which does not impose any tax on buildings. In December, 1939, City Clerk A. G. Brine stated:

> This method of taxation has proved satisfactory as far as we are concerned. A number of industries have been induced to locate in New Westminster on account of the system. Home owners are encouraged to improve their properties because no additional tax is levied. The city's financial status compares favorably with that of other cities in the province.

In Alberta the cities of Red Deer and Calgary exempt buildings from taxation 50 per cent. Edmonton taxes buildings used for business purposes 60 per cent and buildings used as residences 50 per cent.

Milk River, a village, secured power from the Legislature in 1929 to exempt improvements 100 per cent. The village is free from debt. The required revenue is raised easily. In 1936, the ratepayers voted three to one against a proposal to go back to the former system of taxation.

From what has been said it would seem that the results of Western Canada's experience with this system of taxation indicate:

1. That had it been introduced before the land boom, when land values were normal, it would have had an important effect in restraining the speculation in land which later developed with such disastrous effects.
2. That, under such circumstances, the results would have been more favorable than they proved, and might have equalled those realized in Australia and New Zealand.
3. That it has demonstrated the benefits derived by taxing land values more heavily than improvements, and
4. That the fact that some municipalities still exempt all improvements from taxation, and are doing so with success, suggests that this system of taxation has more in its favor than some of its opponents in Canada in the past have sought to lead us to believe.

FEDERAL AID IN CANADA [6]

Canada is now experimenting with an interesting form of federal aid to enable municipalities to grant partial temporary tax exemption on low-cost houses. Under the terms of Part III the Dominion's National Housing Act, of which this section became effective in August, 1938, the Dominion Government, under certain conditions, pays 100 per cent of the first year's municipal taxes, 50 per cent of the second year's taxes and 25 per cent of the third year's taxes on the increased assessment resulting from the erection of houses costing $4,000 or less.

The public in all parts of Canada was quick to take advantage of this legislation. Many thousands of houses have been erected. Through its provisions the building industries have received important benefits, unemployment has been reduced to some degree, payments for relief have decreased, the demand for building lots has improved, and the tax base of many cities has been at least slightly extended.

From the Department of Finance, Ottawa, comes the following statement in reference to the results obtained under the Dominion Housing Act:

> It is difficult at this time to evaluate the influence of this part in encouraging the construction of houses costing $4,000 or less. This is particularly true since, at the same time that Part III of the Act came into operation, the lending facilities were extended broadly under Part I of the Act, and particularly so with reference to the lower priced houses. The encouragement given by Part III relating to exemptions undoubtedly did have an influence, and the following figures may be of interest. Taking single family houses built for owner occupancy only, 12 per cent of those financed in 1936 were valued at $4,000 or less, and 30 per cent in 1937. In 1938, during the last 5 months of which the new Act was in operation, the percentage of total single family houses for owner occupancy valued at $4,000 or less increased to 43 per cent,

[6] Information in a letter from H. Bronson Cowan, December 5, 1939.

and in the first year of operations from August, 1938, to July, 1939, inclusive, the percentage was 56.6.

Pennsylvania and California

In municipalities of the United States (aside from some tiny "enclaves of economic rent") the nearest approach to the method of taxation advocated in this paper has been made in Pennsylvania. Under legislation enacted in 1913 the two second-class cities of the state, Pittsburgh and Scranton, made a 10 per cent shift in their real estate tax for city purposes at three-year intervals, until the rate on buildings became half that on land values. The law made no provision, however, for a further shift after the 50 per cent stage had been reached, nor did the legislation permit the application of the graded tax plan to school and county revenues. The demonstration would be much more conclusive if the Legislature were to authorize a further extension of the graded tax plan for which, in Pittsburgh, at least, there is considerable demand.[7]

Irrigation districts in California have had 30 years' successful experience with an extensive application of the principle of land-value taxation. The irrigation law originally provided for the taxation of both land and improvements. But in 1909 the law limited assessments in all new irrigation districts to land values only, and permitted the five irrigation districts then existing to adopt the new system by a majority vote of the resident landholders. Today more than 1,500,000 acres of California land in the most fertile

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[7] Additional details regarding the experience of Pittsburgh and Scranton will be found in "Differential Taxation of Land and Buildings," by Harold S. Buttenheim in *Municipal Finance* for October, 1938. For information regarding legislation and constitutional amendments proposed in other states, see "Unwise Taxation as a Burden on Housing," by the same author in the *Yale Law Journal*, December, 1938.

valleys and the richest section of the state are operated under this system.[8]

Conclusion

To summarize the case for taxing buildings at lower rates than land values:

Taxes on improvements created by capital and labor have effects directly opposite to those of taxes on site values created by the community. For improvements the potential supply is practically unlimited; for land it is definitely fixed. To release the forces of construction for new housing and modernization, the need is for loosening the brakes now imposed on such construction by high taxes. A low rate of taxation on real estate improvement is, therefore, economically and socially important.

The reverse is true in the case of land: out of a supply whose total is fixed, the amount made available for building sites at prices favorable to developers increases as owners find it too costly to hold land out of use for speculative profits. The higher the tax in proportion to the value of the site, the lower the margin between the capitalization of the tax and the selling price of the land tends to become.

For these and other reasons, I favor modification of the present system of taxing real estate, so that over a period of years a steadily increasing amount of the tax would be transferred from improvement values to site values. Such a shift, properly adjusted, would not decrease municipal revenues from real estate, but would lessen the tax burden on home owners and investors in well-improved property, while giving to owners of substandard buildings or vacant land a much-needed spur to property improvement.

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[8] *See* "Progress Toward Land-Value Taxation Throughout the World" by Bolton Hall, in *The American City* for August, 1936.

PART THREE

JUSTIFICATION OF THE PROPERTY TAX

CHAPTER X

THE PROPERTY TAX AS A MEASURE OF ABILITY

CLARENCE HEER

Federal Security Agency

ADEQUATELY to discuss the place of the property tax in a system of ability taxation is a task which involves considerably more than surface appearances might seem to indicate. In the first place, it involves discovering whether the term ability has any core of meaning which will be acceptable to a sufficient number of persons to make its use worth while. In the second place, it involves ascertaining what role, if any, the ability principle ought to play in a modern scheme of democratic taxation. In short, the modest question which I have been asked to discuss involves nothing less than an entire philosophy of taxation.

In the United States, at least, the ability principle will always be associated with the name of its great protagonist, the late Professor Edwin R. A. Seligman. In terms of a practical fiscal program, the ability theory meant to Professor Seligman, among other things, increased reliance on the progressive personal income tax and on inheritance and estate taxes. We all know the tremendous progress which the country has made during the last 30 years as regards its use of these three taxes. To the extent that a development of this kind can be ascribed to the influence and

efforts of any single individual, recognition is surely due to Professor Seligman.

Professor Seligman's valiant efforts in behalf of his particular conception of ability exposed him to an inevitable risk—the risk of being credited with all of the errors and exaggerations which at one time or another have been identified with the word ability. In justice to his work and writings, it is perhaps worth pointing out that Professor Seligman did not regard the ability principle as the ultimate and all-sufficient canon of taxation. Although he was always careful to distinguish sharply between taxes, on the one hand, and prices, fees, and special assessments, on the other, he emphasized that modern governments perform many services which may appropriately be financed by means of the second type of charges on a benefit or *quid-pro-quo* basis.

Even in what he regarded as the field of taxation proper, Seligman recognized that there were certain socially desirable types of taxes which could not be justified under the ability doctrine; at least, not if that doctrine were interpreted from a strictly individualistic point of view. To make room for taxes of this kind, he advanced in a paper delivered before the Congress of Arts and Sciences in 1904 what he called the "social theory" of taxation. So far as I know, he never abandoned this theory which he considered as supplementary to the principle of individual ability.

The few observations which I have to make on the ability principle of taxation may, or may not, correctly reflect Professor Seligman's philosophy. It is my personal belief that they do. At any rate, they represent the effects upon the mind of a student of the teachings and writings of a great fiscal thinker. The teacher is, of course, not responsible for his students' interpretations of his teachings.

Justification of Taxation

In a democracy, it appears to me that the ultimate justification of all taxation is the general social welfare. In other words, in a democracy any taxes or systems of taxes are justifiable if it can be shown that in their levying and spending, they promote accepted social objectives more effectively and at less sacrifice of other social values than alternative ways of accomplishing like results. If any of our existing institutional arrangements produce results which are out of harmony with prevailing ideas of what is in the public interest, there is nothing in the ability doctrine, as I conceive it, which prohibits the use of taxation as a direct instrument of social reform, provided only that taxation is an effective instrument for the purpose in view. In cases like this, Seligman's *social theory* of taxation directly applies.

But to say that any taxes are justifiable provided that they promote the general welfare more effectively than available alternatives is to enunciate a principle which is of very little value to the public officials and legislators who are periodically confronted with the problem of raising the vast and steadily increasing sums required by our modern governments, and who must devise taxes and tax systems to that end. To maintain that taxes should be selected with a view of promoting desirable social and economic objectives is a far cry from specifying the exact way in which each new amount of needed revenue is to be raised. This dictum, moreover, does not remove taxation from the field of controversy. It goes without saying that there is little agreement among us as to what will promote the general welfare. Even when we are in substantial agreement as to social ends, we sometimes disagree violently as to the means

to be employed. Moreover, the needs of our governments for revenue are not necessarily correlated with the opportunities for social and economic reform through the medium of taxation.

All taxes inevitably produce economic effects of one sort or another. The need for taxes, however, ordinarily arises out of demands for public services, and these demands are seldom accompanied with specifications as to the particular kinds of tax effects which the public prefers. In the absence of a specific mandate concerning the way in which each new demand for revenue is to be met, public officials and legislators obviously need some general rule or formula to guide them in apportioning the burdens of taxation. Such a rule must command widespread support as being just and fair. This is merely another way of saying that the social and economic effects flowing from its application must be in harmony with prevailing ideas of what is in the general welfare. The rule, however, must do more. In its application to individuals, it must appeal to a majority of them as treating all equally with respect to some pertinent criterion. It is in supplying a rule of the kind just described that the principle of ability has performed a useful function in the past and will, I believe, continue to serve a useful purpose in the future.

The Meaning of Ability

The word ability, like the words democracy, liberty, and Americanism, has carried a variety of connotations and still suffers from a multiplicity of meanings. In one sense the word may be regarded as a symbol capable of arousing a certain degree of emotional response. In another sense it may be regarded as representing certain objective rules or formulae for apportioning the burdens of taxation. Finally,

the word has become identified with the particular theories or rationalizations advanced to support the several formulae which have claimed the ability label at various times.

From a practical point of view the ability principle is important mainly as an objective rule of tax apportionment. Seligman tells us that the rule or norm of taxation associated with the term ability has shifted with changing conditions from expenditure to property, from property to product, and from product to net income. This, however, interests us merely as historians. What we wish to know is what the ability principle means now. If we address our inquiry, not to the theoretician, but to the average man on the street, the answer I believe will be readily forthcoming. To the average man today the ability rule of taxation means in the main three things. First, the apportionment of tax burdens progressively according to individual income. Second, the exemption from taxation of certain minimum incomes, including appropriate adjustments for dependents. Third, somewhat heavier taxation of incomes derived from property than of incomes derived through personal effort.

For the present purpose, all that we need to know is what the common man means by ability—a rule of apportionment which appeals to him as being fair. We need not concern ourselves with the various theories, of a psychological or other nature, which have been put forward in support of the current objective ability formula. Professor Slade Kendrick has recently subjected a number of these theories to a critical analysis and finds that they are based on untenable assumptions. I thoroughly agree with Professor Kendrick's main conclusions. Unlike him, however, I prefer to identify the ability principle of taxation not

with the theories which he rejects but with the objective rule of taxation which he apparently supports. The average man associates the ability-to-pay principle with a particular rule of tax apportionment and not with an economic theory. As long as the economic effects resulting from the application of the rule are considered good, it would seem extremely unwise to jeopardize that rule by discarding the term which stands as its symbol, especially since the symbol has become charged with a strong emotional content.

I hope I have made my own interpretation of the ability principle of taxation sufficiently plain. Briefly, ability symbolizes an objective formula, the chief requirement of which is that taxes be apportioned progressively according to individual income. This formula is applicable only in the absence of opportunities to raise revenue in ways which produce economic and social results which are conceived to be more desirable than those which result from the use of the ability rule. The sole justification for the particular formula which now carries the ability emblem is that some general norm of taxation is a practical necessity and that the average man today evidently considers the social consequences of the present norm as being on the whole preferable to the social consequences of any other known alternative.

Place of Property Tax in Scheme of Ability Taxation

In the light of the above interpretation of the meaning of ability, we are now prepared to consider what place, if any, the property tax may appropriately occupy in a scheme of ability taxation. If by the property tax we mean the general property tax regarded as the sole element of a tax system, our consideration need not consume much time. American tax literature of the last 50 years is full of evidence

to the effect that the general property tax under modern conditions falls signally short of meeting the requirements of the ability concept.

I shall not weary you with the repetition of a story which has long since become stale. As everyone knows, the practical impossibility under present-day conditions of administering the general property tax effectively, the lack of uniformity and precision in assessments, the escape of intangibles and other mobile forms of personal property, and the administrative difficulties connected with the treatment of debts, all operate to make the general property tax both unequal and regressive. The failure of the general property tax adequately to reach the enormous volume of non-property income, and the frequent lack of correspondence between the market value of property and its income-yielding capacity contribute toward further violations of the ability formula. Since it is administratively impossible to determine the net worth of individuals, progressive taxation is ruled out.

All of the strictures against the general property tax which have just been enumerated apply when the tax is actually borne by the individuals upon whom it is levied. But the general property tax, as it is found today, is a general tax in name only. Large classes of property entirely escape its operation, either by virtue of express statutory exemption or by virtue of lax enforcement. The fact that the general property tax does not apply at uniform rates to all kinds of property in all parts of the country makes possible a considerable amount of tax capitalization and tax shifting. Such evidence as is available would seem to indicate that the final distribution of shifted property taxes in no sense conforms to the ability principle. Neither would there appear to be any correlation, inverse or otherwise, be-

tween the ability to shift property taxes and ability to pay.

The taxation of real estate constitutes the backbone of the general property tax in the United States. For the country as a whole real estate represented no less than 77 per cent of the total of all property assessments in 1932. Probably the largest single share of our property tax collections is derived from levies on residential real estate. This element of the property tax is in large part a tax on expenditure for housing. Individuals at the lower end of the income scale ordinarily spend a higher proportion of their income for housing than do those in the upper income brackets. Thus, according to the findings of the Brookings Institution, families with incomes under $1,500 per annum spent on the average one-third of their income for shelter and home maintenance in 1929. At the other extreme, families with incomes over $25,000 per annum spent on the average only 12 per cent of their income for these purposes in that year. It may be concluded from this that the property tax on residential real estate is a regressive tax, falling almost three times as heavily on the poor as on the wealthy.

Because farming operations require a comparatively large amount of real estate per dollar of income yield, a substantial portion of the property tax in the United States is collected from farm owners, a low income group. Because of his inability to control the supply of his products, it is extremely difficult for the farmer to shift his taxes. Capitalization, on the other hand, offers a means of escape only to the new entrant into the ranks of farm owners or to the farmer who is increasing his holdings.

A third important share of property tax collections in the United States is derived from levies on business property including the property of public utilities. The incidence of this part of the tax is not uniform but to the ex-

tent that it is added to prices and passed on to the consumer, it becomes in effect a tax on expenditure and, hence, regressive when measured by the ability standard.

Although the general property tax considered by itself is obviously regressive, the fact is that property taxes in the United States are found in conjunction with highly progressive income and inheritance taxes. This raises the question of whether the property tax, or at any rate a tax on real estate, cannot be justified as a convenient way of shifting a part of the tax burden to the large group of individuals with incomes below our present liberal limits of income tax exemption. There are several reasons for answering this question in the negative, but only one of them must suffice.

With respect to incomes above the level of income tax exemption, roughly incomes above $2,000, the distribution of our tax burden, as shown by the admirable recent study of the Twentieth Century Fund, Inc., is distinctly progressive. This result is brought about by our steeply graduated income and inheritance taxes. As regards income groups below $2,000, however, our present tax system is regressive. In other words, families with incomes averaging around $500 per annum actually bear a relatively heavier burden of taxation than do families with $2,000 incomes. This reversal of the rule of ability taxation is due in large part to the regressive effects of shifted property taxes. Since over four-fifths of all families and unattached individuals in the United States have incomes of $2,000 or less, it is apparent that the vast majority of our population, despite the income tax, is subject to regressive taxation. It is unnecessary to add that progressive taxation covering a fifth of the population at the upper end of the income scale con-

stitutes no justification for regressive taxation of the remaining four-fifths of the population.

Since the ability principle calls for higher taxation of income from property than of income from personal effort, it might be asked, finally, whether a general property tax in conjunction with a personal income tax might not be justified as a way of placing the desired additional burden on property income. The answer to this question must be another negative, since from an administrative point of view it is much easier to apply the differential rate directly through the income tax.

To summarize the entire discussion, there appears to be no place for the property tax in a scheme of ability taxation. This is not to say that the property tax, or at least the tax on real estate, does not supply an appropriate means of financing beneficial local services that increase the value of real property or that save landlords and tenants out-of-pocket expense. Nor does it rule out special taxation of the site value of land. These particular applications of the property tax, however, find their justification on other grounds than that of ability to pay.

CHAPTER XI

THE PROPERTY TAX AS A BENEFIT TAX

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MEANING OF BENEFIT TAX

WHAT is a "benefit tax?" In some quarters the expression would be considered redundant. The justification of all taxes is that they support the government in providing for the common good. There is thus a distinct benefit relationship between total tax revenues and public services rendered. If interpreted in the narrower sense, so that the term "benefit" denotes some specific service rendered to the taxpayer by the state, the expression "benefit tax" might be criticized as self-contradictory in character. It is generally agreed that a tax is a compulsory contribution exacted by governments from private individuals *without reference to special benefits conferred.* There is no necessary relationship between the amount paid by a taxpayer and the amount of benefit directly received. Thus, a distinction is drawn between taxes on the one hand and prices, fees, and other administrative revenues on the other. In the case of a tax, in the pure sense of the word, the payments involve no *quid pro quo* to the taxpayer; the benefit is not susceptible of direct measurement and a particular advantage, if it exists at all, is an incidental result. Prices,

and the several types of administrative charges, exhibit, in varying degree, differences in importance of individual advantage measured by special benefit, as contrasted with the common interest or public purpose.

In distinguishing between taxes and the somewhat less compulsory and more contractual revenues Seligman stated: "The essential characteristic of a fee is the existence of a measurable special benefit, together with a predominant public purpose: the absence of public purpose makes the payment a price; the absence of special benefit makes it a tax." [1] As individualistic theories of the state are modified or replaced by collectivistic doctrines the separation of the notion of private benefit from tax revenue grows more pronounced. The government is charged with the broad duty of promoting human welfare and social progress. Group welfare is put ahead of individual benefits. The contemporary viewpoint in taxation is thus "a product of the growing social solidarity and sense of common social obligation that have characterized human progress during the last hundred years. The contributory element in the modern tax concept emphasizes the greater social unity, and the stronger sense of common burden and responsibilities which are a feature of modern life. . . . This conception of the nature of taxation is inimical to the view that taxes are payments for specific services rendered to the taxpayer by the state." [2]

However, the survival of such non-tax revenues as public prices, fees and special assessments indicates that the principle of charging for measurable benefits has not altogether been abandoned in modern fiscal systems. Moreover, there appears to be a strong flavor of individual benefit in the

[1] E. R. A. Seligman, *Essays in Taxation*, p. 431.
[2] H. L. Lutz, *Public Finance*, p. 317.

handling of gasoline tax and old-age security tax revenues. In the former case the tax paid on gasoline consumption is rather closely related to the benefits derived from the use of public highways and the revenues collected from the taxation of motor fuels are usually devoted to highway construction and maintenance. Similarly, old-age benefit payments are computed in proportion to the tax contributions of the workers.

Here it seems possible to trace the benefit of certain governmental services to particular groups. It may, however, be argued, and rightly so, that the automobile owner is not the sole beneficiary of the highway and further, that the revenues from gasoline taxes are not always applied exclusively to highway funds. Or else it may be asserted that while present social security taxes are levied on the principle of "benefit in proportion to contribution" this does not justify the retention of the policy. Other countries of the world are known to provide pensions that bear no direct relation to the contributions of the beneficiaries.

Nevertheless, these examples would seem to indicate what we might call a kind of "twilight zone" between prices or administrative fees and taxes, where all the essential elements of taxation are present, but where some degree of specific or measurable benefit is recognized. A compulsory contribution may be required by the government from certain individuals or groups for defraying the general costs of public services, in exchange for which *the taxpayer is guaranteed no specific return;* yet, the handling of such revenues may be so directed that certain benefits are clearly traceable to the taxpayers in question. When such is the case, the tax is evidently a general revenue device which, partly because of public policy and partly for convenience in administration, has been substituted for a more compli-

cated series of special fees or prices. Under circumstances where a charge for the benefits received does not defeat the very purpose of the expenditure, there would seem to be a legitimate basis for applying the cost of service or benefit principle. Such revenues are not taxes in the "pure" sense but are hybrid or "quasi-tax" measures conforming in general to the definition of a tax, but including certain features of the administrative fee or public price.[3] In this category belongs the so-called "benefit tax."

The General Property Tax

In what respects does the general property tax answer this description? In the early history of this tax, property was regarded as the best objective test of ability to pay. In pioneer agricultural communities the value of property therefore served as the base for most tax measures. However, in the transition from a simple to a more complex economy involving corporate structures and different varieties of intangible wealth, many well-known theoretical and administrative defects arose. As a result other objects of taxation, notably net income, were proposed as more acceptable tests of ability to pay. Without going at great length into the history of the general property tax, its present status in the United States may be summarized by saying that:

1. Property taxes are the main support of local governments and, in addition, provide about 6 per cent of state revenues.
2. Classified property taxes have been introduced to an increasing extent in an effort to adjust property taxation to changing conditions.
3. Property taxes have tended to concentrate on real estate, because of outright exemption of intangibles and other personal property,

[3] *See* J. P. Jensen, *Government Finance,* pp. 171–2. *See also* R. Jones, *The Nature and First Principle of Taxation,* pp. 6 ff.

the taxation of this property at especially low rates, or its evasion. (In 1932 real estate represented 77 per cent of total assessed value of taxable property.) [4]

4. Urban real estate constitutes the largest percentage of taxable property in the United States. (Real estate assessed valuation in the ten leading cities alone exceeded 25 per cent of assessed value of all taxable real estate in the United States in 1932.)

Urban Realty Taxes

It would be correct, therefore, to conclude that while the question of "benefit tax" has been raised with respect to property taxes in general, the vital issue centers around urban realty taxes in particular. The steady rise in the costs of local government was occasioned not only by the growth of population but also through the assumption of new functions and the expansion of services already undertaken by municipalities. The special difficulties arising out of the depression intensified the problems of local finance and led to organized protests on the part of homeowners, real estate interests and taxpayers' groups against what they termed "unfair discrimination" in the taxation of one class of property for the support of government functions.

The possession of real estate has been taken almost universally by local jurisdictions as one index of the citizen's ability to contribute to the support of his local community. Yet, in the opinion of most authorities in public finance, the value of land and buildings is admittedly neither the sole nor the best test of ability to pay. It is, therefore, pertinent to inquire whether, from the standpoint of benefits received, this unequal distribution of the tax burden is at all justified. In other words, is the real estate tax of the hybrid type, including not only elements of "pure" taxation, but a series of charges for specific benefits received?

[4] A. G. Buehler, *Public Finance*, p. 301.

Classes of Benefit to Real Estate

Broadly speaking, there are two general classes of benefit to real estate from municipal expenditures: [5] (1) Direct services rendered. (2) Activities which produce desirable influences upon real estate values.

The first group consists of repetitive annual services. The second class is associated largely with capital outlays for public improvements which frequently exercise a favorable effect upon surrounding realty values.

In considering these elements of benefit it must be remembered that the property tax is essentially an *in rem* levy. Benefits should, therefore, be thought of primarily in terms of advantages to the property taxed. That the individual beneficiary is an owner-occupier, a tenant, or a speculator is of secondary importance. The significant question is whether the property is afforded services or given special advantages which make it so attractive to owners, tenants and speculators that, directly or indirectly, they are willing to pay a premium for its use or possession. In other words, are the services which are available to properties within the confines of a municipality worth the extra overhead which the cost of these public functions necessitates?

In the category of direct services are those governmental activities which help to make property more suited to the needs of those who wish to occupy, rent, or sell it. Such services include the collection of garbage, rubbish and ashes, and their disposal; the maintenance of storm sewers and sanitary sewers; flood control in sewered areas; the clean-

[5] Part of what follows has been drawn from a previous monograph. For a more complete discussion of this subject *see* E. H. Spengler, "Is the Real Estate Tax a Benefit Tax?" Memorandum No. 5 in *A Report of the New York State Commission for the Revision of Tax Laws*, 1932.

ing of sewers; and the operation of sewage disposal plants. In like manner, such functions extend to the repair of streets, highways, main roads or bridges; the sweeping and occasional flushing of paved streets; the scraping, oiling, and raking of dirt streets; the sprinkling of streets in hot, dry weather; the removal of snow and ice in cold weather; the pruning or spraying of street trees; the erection and care of street and road signs; and the maintenance of proper lighting on streets and roads. Municipal water systems and other public utilities which are partly or fully financed through property tax revenues should also be counted among these services. Fire protection is another benefit, not only in the sense of the protection of property against loss but also with reference to the reduction of the costs of fire insurance. Police protection from the local village policemen to the state militia must also be considered of fundamental importance to the owners and users of property. Moreover, there is much direct benefit to property through such work as the satisfactory regulation of traffic, the elimination of grade crossings and proper planning and zoning of a city.

Most of these services are closely identified with urban life. In the less congested areas of the hinterland many of these services are not at all needed; in fact, life there is usually found to be more enjoyable without them. For those who continue to demand space within the more limited confines of a city, however, most of these functions have been found to be not only desirable, but increasingly necessary.

In addition to the services already mentioned, local governments pay a large annual bill for certain broad social programs such as the provision and maintenance of parks and playgrounds, schools, hospitals, libraries, museums, etc. These functions are a step removed from the idea of direct

benefit to property. They are rendered from the standpoint of the collective group for the benefit of "persons" as such, rather than property. Indirectly, however, they may be considered as beneficial to property to the extent that they exert a favorable influence upon general property values. This same reasoning applies to innumerable capital outlays for fixed improvements. Wherever the physical presence of such improvements has the effect of favorably influencing property values (and the property is not locally assessed for the cost of this improvement) a distinct value benefit results.

Conclusions

The conclusion that may be drawn from the preceding remarks is that at least a part of the property tax revenue goes to pay for services and for capital investments which are of benefit, directly and indirectly to the property which is taxed. But what of it? Should the government in recognition of such benefits, adopt the procedure of imposing separate fees for its services upon all benefitted parties? Should the goal be to make as many municipal activities self-supporting as possible?

A policy of this kind would seem to be extremely undesirable—placing a premium on individualistic interests and reducing to a minimum the recognition of the social need for certain services. It would imply that one might refuse the benefits and therefore pay no fees. It would inflict great injustices in the light of prevailing inequalities in wealth and income. It is vital to recognize that the broad collective interest with respect to such services is paramount, even though in some instances there is present a clear element of individual benefit. In other words, the

principle of taxation should be retained, even though it is a "benefit tax."

If it is felt that some services are more beneficial to certain classes of property than to others and that *each class is equally able to carry its respective tax burden,* the principle of classified taxation might be further extended. Thus, rising land values which are recognized from time to time could be subjected to an increment tax; or land, which is the chief beneficiary in rising realty values, could be exposed to heavier tax rates than those chargeable to improvement values. A building tax might be justified for supporting the greater part of the burden of fire protection, or a sewer tax might be added to the water bill in terms of flow accommodation received. Although property would still be assessed for these taxes, the apportionment of burden in this way might be regarded as more equitable. Alterations of this variety in the property tax system must, however, be introduced with the greatest of care and should be based upon an intelligent understanding of their justification and significance.

CHAPTER XII

COMMONS' THEORY OF REASONABLE VALUE AS APPLIED TO TAXATION

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No attempt will here be made to explain all that Professor Commons includes under "reasonable value." Both the occasion and the writer's qualifications recommend a more limited objective. Professor Commons' phrase certainly includes much more than is usually associated with the term "value"; perhaps "reasonable public economic policy" would better suggest the field covered. At any rate "reasonable value" is broad enough to include Professor Commons' ideas concerning the principles and practices of taxation and it is these ideas that are the subjects of this paper.

A few observations about Commons' general point of view as an economist may be helpful. Commons believes in collective action and he has long championed organized labor and government regulation. But he is no socialist. He disagrees with Veblen who defined intangible property as the "marketable right to get something for nothing." Commons draws a distinction between privilege and goodwill, both of which are elements in his intangible property. Privilege corresponds with Veblen's idea of intangible property; goodwill is based on the reasonable conduct of busi-

ness with the reasonableness judged and enforced by the Supreme Court. Commons is much concerned with increasing the output of the economic system and toward this end he seeks to guard and reinforce the incentives for economic activity. Prices should be stabilized in such manner that efficiency will be rewarded; unemployment insurance should encourage steady employment; taxation should spare the active productive factors and bear upon the passive ones. It is profit (particularly the margin of profit) which makes the capitalistic system go. "Purchasing power economics"—the theory that more equal distribution means greater production—is rejected as unsound.

Before turning to Commons' major thesis on taxation, it may be observed that his analysis of "property" as an institution should be of interest to public finance students. He speaks of three categories of property, *corporeal, incorporeal,* and *intangible.* Translated into usual tax parlance, *corporeal* means tangible, *incorporeal* means credits (including proprietary stocks), and *intangible* means "the present value of future bargaining power of capitalists," that is, goodwill and associated property values. Commons stresses the fact that property, especially in these days, consists of rights to use property. Thus the legislature may take away property without due process of law by unreasonably curtailing the use of property. As a matter of fact, all property really has a double character. On the one hand, viewing the world impersonally, we find physical objects with economic significance; on the other, we have various personal claims to uses and beneficial results of property. This is nothing new of course, but it is still constantly overlooked or confused in the application of the property tax. The unmodified general property tax could be defended if it sought to cover the universe twice,

once impersonally, and once personally. The trouble arises from the fact that the universe is once fully covered, in terms of impersonal values but only partly covered a second time in terms of personal interests or equities.

Reasonable Value as Applied to Taxation

Concentrating now on "reasonable value" as applied to taxation, we may start with the proposition that all taxes have important non-fiscal effects if not a non-fiscal purpose. The section devoted to taxation bears the significant title "The Police Power of Taxation." Commons' point of view on this matter is forcefully stated as follows:

> Taxation then, is the most pervasive and privileged exercise of the police power. . . . Even when not consciously intended to be regulative, taxes nevertheless regulate, for they, like the protective tariff, determine the directions in which people may become wealthy by determining directions in which they may not become wealthy. They say to the business man: Here is profit, there is loss. It is impossible to avoid these effects of taxes, therefore impossible to escape the police power of taxation, therefore impossible to look upon taxes of any kind whatever as merely a means of obtaining revenue according to any principle of equality, or ability to pay, or accumulation of wealth or any standard that looks solely to the acquisitions of the past. Taxation is, in fact, a process of obtaining public revenue by proportioning inducements to obtain profits.

Here we have a clear and incisive answer to those who deplore the use of taxation to achieve non-fiscal ends.

Commons' main interest and objective in taxation can be perceived in what he calls his canon of taxation which he states as follows:

> But if there is another canon of taxation that may be properly applied, namely, the effects on wealth production guided by the public purpose of favoring wealth production, then the man who gets his wealth by mere rise in site-values should pay proportionately higher taxes than the one who gets his wealth by industry or agriculture. In

the one case, he extracts wealth from the commonwealth without adding to it. In the other case, he contributes directly to an increase in both private wealth and commonwealth. Hence, looking at it from the commonwealth, or social utility standpoint, there are two kinds of ability to pay: that ability which varies directly with one's additions to the commonwealth, and that which varies inversely to one's additions to the commonwealth. The first we shall name Ability to Serve, the second, Ability to Pay.

. . . Taxes should be apportioned directly according to a person's ability to pay and inversely according to his ability to serve the commonwealth.

In application of this theory of proper taxation, Commons recommends several possibilities. He naturally favors special assessments, already in quite general practice. Such levies are generally confined to land and are an attempt to recapture the increments resulting from public improvements. In addition, a classified income tax is suggested consisting of a differential rate applied to favor earned as compared with unearned income as Commons defines those terms. A graduated tax on site value is proposed including unique features designed to separate and exclude such intangible improvements as soil fertility. Finally, the classified assessment system of Pittsburgh, under which, in the administration of the property tax, land values are weighted more heavily than improvement values, has Commons' warm approval.

Most unique certainly, are the innovations proposed in the Grimstad Bill, submitted by Professor Commons to the Wisconsin legislature. This embodied the proposal for a state tax on bare land values. Bare land values were to include all real estate values minus value of improvements both tangible and intangible. Soil fertility and other values added and maintained by present and past owners of the land were to be classed as improvements. In general, one-

half of rural land values was to be attributed to fertility. Personal exemption of $10,000 was provided. Thus farms worth less than $20,000 and home sites worth less than $10,-000 would ordinarily be excluded. This made the tax in effect an urban levy and one confined to the owners of fairly sizeable land values.

No suggestion is made of a *single* tax, nor indeed of confining tax measures to the application of a single principle. On the contrary, it is suggested that equal weight might be given in the tax system to the principle of ability to pay on the one hand and inability to serve (if that phrase can be used) on the other: the first to reach incomes regardless of source, and the second to reach the sources which especially invite taxation. While a special tax on sites might appear to be impersonal in character, Commons proposed to apply it with a personal exemption, with non-contiguous holdings taxed as a unit, and with a graduated rate. Thus the two principles in which Commons is interested would in application be commingled.

It is conceded by Commons that the lay public do not often discriminate between sources of income as he thinks they should. To them, one dollar of income is likely to appear like all others in spite of the fact that the first may represent a return for a monopoly of scarce natural resources and the others an active contribution to the commonwealth. At any rate, the layman's lack of discernment affords no excuse for similar error by the professional economist.

So much for the broad outline of Professor Commons' main thesis in the application of reasonable value to taxation. The remainder of this paper will be devoted to criticism and comments.

Comments on Commons' Theory

Differentiation of Income for Purposes of Taxation

It seems that differentiation of income for purposes of taxation might be based upon any one or more of three different grounds. The first is ethical in nature and labels some income as deserved and some as undeserved. The successful promoter of rackets will serve as an example of the recipient of unethical income. Almost everyone would agree that there are rackets and racketeers, some operating illegally and others (perhaps barely) within the law. Producers and distributors of "fake" remedies for human ailments would fall clearly within the class of recipients of unethical income. If we could single out racketeering income for especially heavy taxation, it would be the next best thing to stopping rackets. But the line between rackets and legitimate business is none too clear and is likely to be drawn at different points by different people. Veblen apparently took the view that all business of the financial (as distinguished from the engineering) type is more or less a racket. It is doubtful if he would have shared Commons' confidence that the Supreme Court can be relied upon to filter out the impurities in capitalistic income. Commons himself would be among the first to insist that many institutions once supported on theories of natural right have valid sanction mainly in custom. Under other institutions income would be differently distributed.

There can be no doubt that income does differ in moral character. But the differences are so subtle and so much a matter of opinion that differentiation on this ground for purposes of taxation would be very difficult to manage.

There are those who would support an undifferentiated

but heavily graduated income tax upon the proposition that the moral worthiness of income depends upon its *quantity*. They would hold that quite aside from the source of income no man is justified in claiming dominion over more than a certain amount of it. They might argue, for instance, that any person should be content with an income of $10,000 and if he seeks more it is evidence of greed or lust for inordinate power. The author has much sympathy for this heresy but the approach here while moralistic is quantitative rather than qualitative.

Those who hold that economic rent should be singled out for extraordinary taxation base their case only in part upon the view that landlords receive an unethical income. Moreover, most of those who think the landlord guilty would agree that at least in our modern era, he is by no means the only "thief."

A second basis of differentiating income is according to the effects upon future production which taxing it would have. This is a matter of the necessary rewards for the incentives. Income may be regarded as a sort of "bribe" to induce economic activity and forbearance. "Bribes" should not be paid unless necessary and they should be kept at the minimum required. Here the case for taxing economic rent appears strongest. Its proponents claim that income from land values is the most conspicuous case of reward to a passive factor in production which might be taxed away without social detriment. God gave us 25,000 miles of the earth's circumference and we would still have it if all the landlords were taxed into the poorhouse.

Of course, land rent is by no means the only case of unnecessary or overgenerous payment of these economic "bribes." It was claimed by John A. Hobson in his *Taxation and The New State* that surpluses are rather general

throughout the economic system. Hobson thought that they might be found in profits, interest, salaries, and even to a certain extent in wages. It has often been observed that a talented individual has in his capacities a more or less nonreproducible good, the return for which greatly resembles economic rent. This talent becomes negotiable when it takes the form of a patent or copyright. The corporation executive who receives $100,000 a year for his services may be worth to the corporation what he costs, but he may not be worth it to society in the sense that his services could not be had for less.

The difficulty in taxing surpluses (excess rewards) and sparing costs (necessary rewards) is that the two are distinguishable if at all only with the greatest difficulty. It is thought by many that the surpluses are particularly prominent in the large incomes and that the best program for taxing surpluses is a graduated income tax without qualitative discrimination. It can be argued of course, that land rent at any rate is a clear and distinguishable surplus and that it should be subjected to special taxes even though other and indistinguishable surpluses are not. There is some merit in this contention and we shall return to it later.

The third ground for qualitative differentiation of income is that income from some sources is more potent than that from others. This is the basis for the present differentiation between earned and unearned income in the federal law. The distinction looks not to the "deservedness" of the income, nor to the effects upon production which might follow from taxing it, but rather to the sacrifice involved in making payments. Thus it is said that income from service is less able than that from investments because the former is dependent upon the short and uncertain tenure

of the human faculties. The hazards of age and health have to be insured against before the security of the service income approaches that of the property income. Reliance upon investment may also involve hazards, but it is only a first line of defense with personal earning power available as a reserve. The distinction appears valid in the main, though its application in the federal law is highly arbitrary and may add more complications than its contribution to equity is worth.

The income tax is by no means the entire tax system and differentiation in property taxation may be an indirect way of applying differential burdens to income. This might take the form of classification and a weighted assessment as presently applied in Pittsburgh, or it might take the form of a special state tax on bare land values (as proposed by Commons in his Grimstad Bill) or of a special municipal land tax. The last would usually require sanction by the state legislature and in many states would probably necessitate amendment of state constitutions. Uniformity clauses are a solid barrier to such programs. Nevertheless, if the programs are sound and valid the barriers might not prove insurmountable.

Graduated Tax on Land Values

Professor Commons' proposal for a special state graduated tax on bare land values (with allowance for fertility, and with a graduated rate and personal exemptions) is sound in its differentiation between urban and rural land. Soil fertility, an important element in rural land, is economically an exhaustible and reproducible factor, properly classed with capital. Separation of site values from soil values, however, is no simple administrative task. Commons proposes an arbitrary and complicated procedure

which is mainly acceptable, if at all, because most rural land is covered by a personal exemption. Some will object to the mixture of personal and impersonal factors in Commons' program but the combination can be justified as an application of the two canons of its author. However, since municipalities are in need of a new source of local revenue and land taxes are excellently adapted for local use, a simple system of special urban taxes upon urban land or the Pittsburgh classification plan would appear to be preferable.

It was said earlier that it is better to prevent a racket than to tax it and this view might seem to justify public ownership of city land. As a matter of fact, a strong case can be made for the public ownership of city sites, and a very much stronger one could have been made at a time when our country was being pioneered, and population was rapidly increasing. The strongest argument against such a program is that many cities have shown scant capacity for the administration of so large an order as the real estate business.

One of the frequent arguments for taxing land, especially urban land, is that such taxes are capitalized and tend to make land cheaper, whereas taxes on most other bases tend to be shifted forward to the consumer. It is the relative inelasticity in the supply of ground space which supports this view. Inelasticity means that supply will be forthcoming even though little or nothing is paid to suppliers. The supply of rural land is influenced by the fertility element of which we have already spoken. Even urban ground space may be made available by the investment of labor and capital in such intangible improvements as filling and grading. But in spite of these qualifications, the supply of sites remains conspicuously inelastic. However, land investment competes with other investments and unrelieved

special burdens attached to one class of investments tend to be discounted by purchasers. This is the capitalization process which tends to diffuse the burden of land taxes among successive generations of owners. The widely accepted rule that land differs from capital in the incidence of taxation needs considerable qualification (more than can be here presented) but appears to rest on solid ground.

Many will deplore any suggestion of heavier taxes upon land and point to the recent and even the present tax delinquency of real estate as proof of the impracticability of such a program. It is said that land income has long been the target of the tax system and that the latter must look elsewhere for new revenue. However, if cities should acquire some land by tax delinquency foreclosure, the result might not be entirely opposed to the public interest. Stronger it seems, is the argument that land values often involve saved earned income exchanged for land and that land ownership is poorly correlated with personal ability to pay. Strong and valid objections on equitable grounds can be urged against too drastic a program of land taxation.

Considerably involved in the problem of land taxation is the proper basis of assessment for taxation: whether land should be assessed on its annual value (as is customary in Europe) or upon its selling value (as is customary in the United States) or whether it should be taxed upon its actual income as distinct from either. Time will not afford much discussion of these questions on this occasion. The selling-value basis of assessment taxes anticipates income before it arises. This adds to the problem of delinquency and further divorces land taxation from current ability to pay. It is, however, a method of taxing increments and to some extent of preventing them. The fact that our tax

system does not otherwise tax increments (except perhaps as capital gains) favors retention of the present procedure.

Conclusion

In conclusion, it is the essence of Commons' view that different kinds of wealth and income differ in their suitability for taxation and that the tax base should be classified qualitatively as well as quantitatively. Particularly land rent should be singled out for specially heavy taxation. These propositions are strongly supported by the argument that payments to passive elements in production represent a social surplus, that such elements require no reward, and that (because of these facts) they can be taxed without raising prices to the consumer. If these theoretical propositions are accepted, there still remain a host of problems in their application. Should rural land be included in the program and if so what is to be done about soil fertility? Should the differentiation between land and other wealth be made in the property tax or the income tax or both? If in the property tax should it take the form of a classified assessment, a special state tax, or a special municipal tax? Should land be assessed on its annual or its selling value? Why not remove the problem of taxing city land by having the city acquire title to all sites? No attempt has been made to treat exhaustively the argument involved in answering these questions. The author's view concerning most of the answers has been suggested. His vote is for either a differentiated property tax, favoring improvements as distinct from land, or better still a special municipal property tax on city sites. In his opinion, it is simpler and better to leave rural land out of a special land taxation program. As for the income tax, in the interest of simplicity in that rapidly-becoming-incomprehensible institu-

tion, the vote is for an undifferentiated tax graduated according to quantity. The argument for basing property taxes on annual as compared with selling values appears to be about even.

In these days when we are threatened with tax limitation laws, homestead exemptions, gross income taxes and sales taxes, the sound economic considerations supporting the taxation of land value needs to be re-emphasized. Commons' "Reasonable Value" does this and does it well.

CHAPTER XIII

CAPITALIZATION AND SHIFTING OF THE PROPERTY TAX

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THIS paper will be devoted primarily to capitalization of the property tax, with only incidental reference to shifting. The first part will summarize the theory of capitalization as it seems to be generally accepted at present, and the concluding part will offer some suggestions for further exploration.

THEORY OF CAPITALIZATION

Illustration of Capitalization

The value of a piece of property depends upon an estimate of its future net income (viz., the value, expressed in money, of the services it will render) and the rate at which the income is capitalized. For example, one person thinks a certain property will yield a net income of $1,000 a year forever, and is willing to capitalize at 5 per cent; therefore, he bids $20,000 for the property. Another estimates the net income at only $900, but is willing to use a 4 per cent rate in capitalizing, and hence bids $22,500.

If a fear develops in the mind of the prospective purchaser, that the net income from the property will be diminished by an added amount of tax to be collected

sometime in the future, he will of course be impelled to revise his bid downward by the amount of the prospective increase in tax—the amount, that is, discounted to a present value by the application of the particular rate of interest that he associates with this property. Thus if he thinks that a year from now the property will be subject to a special, once-for-all increased tax payment of $100, his bid will drop by the present value of $100. In terms of the example above, the highest bidder will lower his offer by $100 discounted for one year at 4 per cent, that is, by roughly $96; hence he will offer, not $22,500 for the property, but $22,404. In the more usual case he foresees, not a single once-for-all increased tax payment, but a series of such increased payments stretching far into the future. For instance, he may think that the property will have to bear an increased tax of $100 next year, $100 the year following, and so on forever, as will be the case with land if he expects a permanent rise in the tax rate, or a permanent change in the assessed valuation. He will then have to subtract from his former bid price, not merely the present value of next year's added tax burden, but also the present value of the added burden of the second year, of the third year, and so on forever. In that case he lowers his bid price, not by $96, but by $2,500, since this is the present value of a series of payments of $100 a year forever with interest at 4 per cent. Thus his bid price drops from $22,500 to $20,000.

This particular illustration assumes, of course, that none of the tax can be shifted to anyone else; it also presupposes that the government does not spend the tax revenue in a way that either adds to or subtracts from the net-income-producing power of the property, or lowers the rate at which the net income is capitalized.

It has been implied above that the value of chief interest is the value to the prospective or possible purchaser whose bid is the highest—or to put it the other way around, no attention is paid to the price at which the existing owner is willing to sell the property. But it may be useful to think of capitalization of the tax in terms of the owner's own offer, or withholding, price. Thus if he estimates the income at $900 but is willing to capitalize at 3 per cent, his own offer price is $30,000, before knowledge of the tax increase. He also uses a 3 per cent rate in capitalizing the tax increase; thus his offer price is lowered by $3,333 to $26,667. We have seen that the highest price bid by a prospective purchaser dropped by $2,500, from $22,500 to $20,000. The property remains in the hands of the existing owner, under these conditions, but which is the more significant thing to say—that the tax has been capitalized into a decrease in value of $2,500 or $3,333? Probably one or the other will be the better, according to the type of problem being analyzed; the chief necessity will be to make clear, in any particular discussion, which one is referred to.

The aspect of this phenomenon of capitalization that has attracted most interest is the situation of the person who buys the property in the light of the prospective increase in tax. If the increase does materialize and if it does not itself affect the rate of capitalization (a matter to be discussed below) he still has suffered no loss in money value of his holdings thereby; had there never been any prospect and materializing of the increase in tax, he would have paid a correspondingly higher price for the property. Therefore, so far as loss in money value of property is concerned, he is in no position later to complain that this part of the tax burdens him unfairly—a conclusion that holds

no matter how large this part may be.[1] The same conclusion (no loss in money value) would hold for the rest of the tax—the old tax—except, again, as it may itself have affected the rate of capitalization.

Some interesting corollaries have been drawn from this conclusion, three of them being of special importance:

1. The tax in question gives the new owner no claim to exemption from any new general tax designed to strike all persons, property, or incomes;

2. A subsequent lowering or repeal of the tax in question would be an undeserved gift by the government to those who had capitalized the tax when purchasing [2] (for some pieces of property such a lowering of tax may result from a reform of assessments that lowers some property values relative to others—an illustration of the general tendency of past tax capitalization to induce us to accept the present situation, though the argument is, of course, not necessarily the decisive one);

3. The owner at the time that the prospect of an added tax develops may thereby lose in value far more than one year's tax—may indeed suffer a loss far heavier than any that the legislator would be willing to impose on him by some direct, personal tax.[3]

Effect of Tax on Net Interest Rate

Up to this point it has been assumed that the prospective tax does not itself alter the net rate of return that purchasers of the taxed capital demand—or generally, the rate

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[1] For the early literature on tax capitalization, which was especially concerned with this point, *see* Edwin R. A. Seligman, *The Shifting and Incidence of Taxation* (4th ed., revised), pp. 174–83.

[2] *See* John Stuart Mill, *Principles of Political Economy* (Ashley ed.), pp. 820–21; Alfred Marshall, *Official Papers*, pp. 337, 352–54.

[3] Mill, *op. cit.*, p. 810.

of interest that investors in the taxed field demand. If the prospective tax is very limited in scope this assumption is reasonable. But if it extends over a wide field, even though not over the whole field, it is likely to have some effect on both the volume and direction of flow of investable funds.[4] The present discussion cannot do more than barely touch on the effect of the property tax on the rate of interest, but a sample of the kind of analysis will illustrate the point. Capital will tend to flow from the taxed field to the untaxed field, but users of funds—speaking loosely, borrowers—operating in the untaxed field may not be able to absorb the additional capital and still offer as high a rate of return as before. Thus the rate of interest in the untaxed field would tend to fall. As to the taxed field, the tendency of capital to move away from it will tend to raise the rate of interest that the borrowers must pay there (compared to the rate they would pay without the tax).[5] This borrower's rate of interest must be distinguished from the lender's rate of interest, the lender's rate being after deduction of tax. If the volume of investable funds tends to be restricted as the lender's rate declines, a new equilibrium will be reached at some point where (1) the borrowers in the untaxed field are paying a lower rate of interest than they would otherwise have paid,[6] (2) borrowers in the taxed field are paying a higher rate of interest than they would otherwise have paid, (3) lenders in the taxed field are getting, after tax, the same return as lenders in the untaxed field, and (4) lenders in both fields are there-

[4] M. Slade Kendrick, "The Incidence and Effects of Taxation; Some Theoretical Aspects," *American Economic Review,* XXVII (Dec. 1937), pp. 730–31.

[5] But lower than the rate they would have to pay if the tax was so narrow in scope as not to affect the lender's rate of interest.

[6] In this analysis, "untaxed" means the same as "non-taxed"—i.e., it does not imply that the property in question used to be taxed.

fore getting a smaller return than they would otherwise have received.[7] The significance of these conclusions for the capitalization theory is that the interest rate at which the income is capitalized is reduced by the tax itself, and since the lower the interest rate the higher the value, the property does not drop in value as much as it would if the tax had not lowered the rate. In other words, the tax, if spread over a wide enough field, exercises two counteracting forces on the value of property. By lowering the lender's rate of interest (and it is this rate that is used in capitalizing the tax) it tends to increase all property values, and the net result is an increase as concerns the untaxed property. By lowering the yield of the taxed property it tends to lower its value, and the net result is a lowering of the value of that property.[8]

In this case there has been some uncertainty how to use the term "tax capitalization"—whether to use it to include the effect of the tax on the interest rate.[9] At this point it

[7] For instance, if the rate of interest is 4 per cent and if a special 20 per cent income tax imposed over a large part of the investment field forces the borrower's rate of interest in the taxed field up to 4.5 per cent, it follows that lender's rate of interest in that field is now 3.6 per cent and, in the untaxed field, both borrower's and lender's rates are likewise 3.6 per cent (hence capital already fixed in the untaxed field tends to rise in value).

[8] Actually the problem is much more complex than this sample of analysis might indicate, if only because it ignores the use made by the government of the money. [This analysis does not cover the case brought up by Professor Harry Gunnison Brown in the discussion before the American Economic Association subsequent to the delivery of this paper. That case postulated, not an additional tax levied on both land and improvements within a certain field as in the text above, but an additional tax on land with a corresponding reduction of tax on improvements. In that case, as Professor Brown pointed out, the tendency would be for the lender's rate of interest in the improvements field (and hence also in the land field) to increase, with a corresponding downward pressure on the value of land—a pressure supplementing the one caused by the decrease in land income brought about by the added land tax.]

[9] Seligman, *op. cit.*, p. 218; compare his later views, somewhat modified, in "The Effects of Taxation," *Political Science Quarterly*, March, 1923, pp. 3, 6, 9–10; and Kendrick, *loc. cit.*, pp. 729–32. Griziotti defines capitaliza-

will be used to refer to the combined effect, expressed in terms of capital value, on the interest rate and on the net income from the property; but this is done in full recognition of the possibility that in many analyses—perhaps indeed in most—it will be convenient to isolate the counteracting forces more sharply by restricting "capitalization" to mean the change in value that would have occurred if the tax measure in question had affected only the income from the property and not the lender's interest rate. (In fact, in the second part of the present discussion the term will be used in this narrower sense.)

Similarly, where the analysis has postulated a universal tax on property or its income, so that there is no tax-free property available, there has been some doubt whether "capitalization" should refer also to the effect, if any, on the lender's rate of interest. Incidentally, the only way in which it can be shown that a general tax levied equally on all investments is not capitalized is to define capitalization to include the effect on the lender's rate of interest; for the only case in which capital values will be unaffected by the general tax is when this tax lowers the lender's rate of interest by just enough to offset the cut in the income caused by the same tax. The odds seem to be decidedly against a lowering of exactly this amount, especially when the use to which the government puts the revenue is taken into account.[10]

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tion ("amortization") in the wider sense. *See* Benvenuto Griziotti, "Teoria dell'ammortamento delle imposte e sue applicazioni," *Giornale degli Economisti,* Jan., 1918, pp. 15–19.

[10] For an analysis of three possibilities with respect to the use of the revenues and their relation to tax capitalization, *see* Luigi Einaudi, "Intorno al Concetto di Reddito Imponibile," *Memorie della Reale Accademia delle Scienze di Torino, Serie Seconda, LXIII* (1913). *Scienze Morali, Storiche e Filalogiche,* note 1, pp. 287–89.

Other Points with Respect to Capitalization

Before concluding this first part of the paper, attention may be called briefly to the other chief points that have been developed with respect to capitalization of the property tax:

1. A property tax at a given rate levied on capital value rather than income will, so far as it forces assessed property values down, automatically lighten the burden it imposes in terms of dollars of tax. Capitalization cannot be expressed in terms of a rate of tax on the capital value before tax.[11] But this factor is presumably offset, in principle, at least, by the setting of a tax rate that is higher than it would be if it did have the old capital values to rest upon.

2. Since the prospect of the change in amount of tax must always be somewhat uncertain, some capitalization, in one direction or the other, may be occurring rather frequently, perhaps almost continuously, as expectations change; indeed, capitalization is one of the examples of tax burden that can occur merely from the prospect of a tax and even though no such tax ever materializes. It has even been argued that one who buys into one type of investment that is lightly, or heavily, taxed compared to others ought to—or does—consider that at some uncertain future date this difference will be lessened by an increase, or decrease, in tax.[12]

3. Although capitalization and shifting cannot both occur with respect to the same segment of tax on the same owner, it is of course possible for one segment of the tax to be capitalized and another segment shifted; and it is

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[11] For this point, and a general statement of the formulas applicable in tax capitalization, *see* Jens P. Jensen, *Property Taxation in the United States*, pp. 63–68, 329–30.

[12] *See* sources cited in Griziotti, *loc. cit.*, pp. 25–26.

possible for the shifted tax to be capitalized by the owner of the property to which it is shifted.

4. The rate at which the income of a property is capitalized will differ, at a given time and place, with the type of property under consideration, even disregarding differences in the length of term of investment. A prospective tax on all these properties will or will not reduce their values in varying degrees, rather than by a uniform percentage, depending on (1) whether the rates of capitalization differ because of a difference that is proportional to the income (e.g., difference in risk) or, instead, because of a factor that is, within a range, independent of the income (e.g., a certain lump-sum value put on the satisfaction of owning one's own home) and (2) whether the tax is imposed on income or capital value.[13]

5. The use made of the tax money makes a difference. If the revenue is spent in a way that increases the net money income of the taxpayer's property before the tax (either by increasing its gross income or decreasing its expenses), or if the government distributes non-monetary income in an amount and quality that induces capitalization at a lower rate,[14] the result may conceivably be no decrease in the money value of the taxed property. Various other cases, ranging from some indeterminate increase in

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[13] Jens P. Jensen, "Tax Capitalization," *Bulletin of the National Tax Association,* XXIII (Nov., 1937), p. 53, and sources there cited. To supplement Professor Jensen's analysis on a minor point, it may be added that in the case that he postulates of desire for home ownership, a tax on an income basis (as contrasted with capital-value basis) would lower the value of the home property by a smaller percentage than it would the value of some other property, the values of the two properties being equal before the tax.

[14] Jensen, *loc. cit.*, p. 55. *See also* the discussion by Simeon E. Leland, "The Real Estate Tax: Capitalization and Benefit," and Edwin H. Spengler, "The Real Estate Tax: Capitalization and Benefit—A Reply" in *Bulletin of the National Tax Association,* XVIII (May, 1933), pp 227–35; K. M. Williamson, "The Taxation of Real Estate: A Survey of Recent Discussion," *Quarterly Journal of Economics,* Nov., 1933, pp. 96–128; Twentieth Century Fund, *Facing the Tax Problem,* pp. 550–51.

value down to the decrease postulated when expenditures yield no benefit, may be imagined.

6. Although the present paper is restricted to capitalization under the property tax, it may be recalled that many other taxes can be capitalized.[15] The proper method of integrating an individual income tax and a corporation income tax, including the treatment of capital gains and stock dividends, depends in part on assumptions, explicit or implicit, with respect to possible capitalization of the income tax on corporations through changes in prices of corporate shares.

Suggestions for Further Exploration

It is evident that capitalization of the property tax has been studied in many of its aspects, over a long period of time. What are some of the next steps in research on this topic that may be fruitful? In its broader aspects the problem covers the effect of taxation on rates of interest; but the points suggested below are confined to tax capitalization in the narrower sense of the term.

In general, it seems that at least three types of research are needed: first, a further development of the theory; second, inductive studies designed both to test the degree to which these generalizations are valid and to raise additional questions; and third, attempts to make explicit the implications that such findings carry for tax policy in the United States. The present discussion will consider in detail only the first type.

Further Development of Theory

In further development of the theory, it may prove useful to examine some of the following points:

[15] Twentieth Century Fund, *Facing the Tax Problem,* pp. 244–45; Griziotto, *loc. cit.,* pp. 4, 7 (wages tax shifted to employers), pp. 8–10 (personal income tax causing increases in rate of interest).

1. The degree to which capitalization of the property tax may occur with respect to improvements (as distinguished from land) under various assumptions of durability and time of renewal. This may lead to some interesting connections with the study of business cycles in general and construction cycles in particular. Tax capitalization is essentially an influence exercised by unexpected tax changes on the value of fixed capital. From this it might seem to follow that the degree of depreciation in value would depend on the durability of the capital in question, the degree of fixity, or, in still other words, the length of time that is to elapse before the owner's capital is to be returned to him. This is not quite the case, however. If, for example, in a community with a steady demand for dwelling accommodations, one twentieth of the dwellings were to wear out completely each year, then each year new dwellings to the amount of one-twentieth of the existing stock would have to be constructed. If the property tax on dwellings (that is, on the improvements that are renewed each 20 years—not the land) were suddenly increased at the start of a certain year, the usual amount of replacement would presumably not occur, the demand not being completely inelastic. On the supposition that, if only one-half the usual amount of replacement occurs, rentals will strengthen enough to cover the increased tax (constant costs being assumed within the range in question), no drop in the value of the old dwellings need occur, even though the life span of each is 20 years. But if, instead, all the dwellings wear out in the same year and all are replaced at once, there is, in 19 years out of the 20, no way to alter the supply immediately by a refusal to build what would otherwise have been built, since nothing would have been built anyway. An unexpected increase in tax occurring in any one of these years will affect the capital values of the existing improvements; the value of each dwelling will decrease by the capitalization of the prospective taxes up to the year when replacement becomes necessary. On the other hand, if the unexpected tax increase occurs at the start of the year in which the com-

plete replacement was to have been made, the supply can be restricted within a short time, or, to put it another way, the fixed capital values subject to infringement are by that time almost zero.

Obviously, the actual situation does not correspond either to the extreme of uniform annual replacement, or to the extreme of periodical complete replacement; and replacement is often supplemented by additional construction. But the existence of construction cycles indicates that the latter extreme—periodical complete replacement—is approached closely enough to make of interest a study that would examine unexpected onerous increases in the property tax on dwellings in the light of the point along that cycle at which they do or might occur.

2. The result obtained under capitalization of the tax is measured, in principle, by comparing what happens to property values under the change in the property tax with what would happen to those values without the change in the property tax; but, under this "without-change-in-property-tax" status (which is a sort of base line for measurement), there are several combinations possible and most of the analyses have been predicated on only two of them. Generally, it seems to have been assumed that if the change in the property tax did not occur, there would be a corresponding lack of change in governmental expenditures either of a kind that would be of no measurable importance for the property in question or of a kind that would presumably benefit the property. A third assumption, more realistic in many instances, is that if the change in the property tax did not occur, a corresponding change would be made in some other tax or taxes. Thus the comparison might be, for example, between (1) the change in property values that would occur if the city of Philadelphia increased the property tax and (2) the change in property values that would occur if it instead imposed an income tax (as has recently been the case). Further illustrations may be

furnished by the recent measures granting homestead exemptions with accompanying changes in other taxes. It is not implied here that one or the other tax measure is preferable or even that in these specific cases the differences could be measured with any useful degree of accuracy; the inference to be drawn is, rather, that this type of problem needs to be studied, at least in its general aspects. If, for example, we postulate that the alternative to a change in the property tax is a change in some other tax, and if, under the change in the property tax, a certain piece of property would be worth $10,000 while under the change in tax X it would be worth $11,000 and under the change in tax Y, $12,000, may we then say that capitalization of the property tax is effective only to the extent of $1,000 or $2,000, as the case may be, or should we continue to measure capitalization by appeal to a third situation that has been ruled out by the basic assumption? In part, this question poses merely a problem of convenience in terminology, but raising it may induce helpful comparisons. Some approaches have already been made to the alternative-tax type of comparison,[16] but most of the work lies ahead. (Of course, the analyst may abstract from every change except the change in the property tax,[17] but he must then state clearly that his investigation has stopped mid-way, so to speak, and at that stage gives the legislator little if anything on which to base a decision. To be sure, an analysis that assumes other things equal may be useful even for policy purposes if the

[16] Harry Gunnison Brown, *The Economics of Taxation*, pp. 239–41.

[17] "Is it not competent to the 'mechanics of industry' to treat superposed disturbances independently and one at a time? If a person wears high heels, may we not estimate the elevation due to that cause without putting him on a hill?" F. Y. Edgeworth, *Papers Relating to Political Economy*, Vol. II, p. 70. But Edgeworth adds, "If indeed there is some connection between the artificial elongation and the position of the wearer, it may be proper to note this." Since a change in the property tax necessarily implies a change of corresponding magnitude in other revenues, in expenditures, in borrowing, or in cash balances (or a combination of these), it seems not only proper, but highly desirable, to take account of these changes, once the analysis of the property tax change alone has been fairly well developed.

tax change in question is small in amount or scope; but not otherwise.)

3. The capitalization of the property tax on intangible personal property, particularly shares of common and preferred stocks and long-term bonds, offers some peculiar problems that may need special attention, especially since the degree of capitalization may depend partly on the extent to which the prospective purchaser thinks he can evade the tax.

4. The fact that market rates of interest commonly differ according to the length of the investment period will make the risk of capitalization a more serious one for some investments than for others. At the present time, when long-term rates are much higher than short-term rates, the risk is more serious for long-term investments. These remarks assume that the tax in question is one on capital value. If it is one on net income (not including, therefore, return of capital), the risk is more serious for long-term investments even if interest rates are the same for all terms.

5. In studies that are designed to indicate the amount of taxation, direct and indirect, resting on persons at each of several specified income levels, the problem of whether to allow for capitalization of the property tax, and, if so, how, is an extremely perplexing one.[18]

Inductive Studies

As to inductive studies of property transfer, changes in tax rates, and other relevant phenomena, the difficulties are great, owing to the expense of obtaining even a small amount of data and the problem of interpreting them after they are gathered, but it may be practicable to study fairly

[18] Mabel Newcomer, "Estimate of the Tax Burden on Different Income Classes." *Studies in Current Tax Problems* (Twentieth Century Fund), pp. 12–13, 22, 33, 35, 40.

small areas, covering a time period long enough to make the results significant.[19]

Application of Findings to Problems of Policy

Finally, the application of the findings, both from generalizations and from specific studies, to particular problems of policy seems, for the near future at least, to be most important with respect to prospective decreases in the property tax rather than increases. Homestead exemptions are a case in point. In reports on revision of particular state and local tax systems, it seems reasonable to expect that the problems created by capitalization of the property tax will receive enough attention both to utilize past findings and to suggest further topics and methods for future research.[20]

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[19] The most important study of this kind of which I am aware is that made by Edwin H. Spengler, in "Memorandum Number 4: Turnover of Title to Real Property in New York," in *Report of the New York State Commission for the Revision of the Tax Laws,* Feb. 15, 1932.

[20] *See,* in the *Report* cited in the preceding note, pp. 37, 43, 46–47, 89–90, 99–100, 127–31, for an example of the application of research on this matter to a particular problem of policy.

PART FOUR

ALTERNATIVE BASES FOR REAL ESTATE TAXATION

CHAPTER XIV

TAXING REAL ESTATE ON ITS INCOME [1]

A Practical Illustration

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REAL estate boards, owners, and especially expert appraisers demand that assessments be based on income—past income in some cases, estimated future income in other cases, whichever will bring home the bacon in tax reduction cases. It is because these complainants do not appreciate the difficulties and problems generally involved in such an approach by the assessor that this demand persists, and that a practical illustration to this problem by an assessor may be helpful.

Recently an operating five-year statement was presented to the assessor by a large hotel owner for the purpose of securing a reduction in assessment. This statement showed that the hotel had, for five years, operated at an average loss of $25,000 for each year. Here then if we appraise this real estate, which is assessed at almost $2,000,000, on this net income basis alone, no value is deducible, a net loss being shown.

[1] Editor's Note: An address presenting the case for the taxation of real estate on an income basis was given by Mr. Herbert U. Nelson, Executive Vice President, National Association of Real Estate Boards. Since, however, Mr. Nelson spoke extemporaneously and there was no stenographic record of the proceedings, we are unfortunately unable to publish his address. We regret this omission.

If the assessor appraises upon a normal income and expense basis, it immediately becomes necessary to analyze the income and expense statement. He must determine whether the expenses are *normal* charges and whether the rents and other income received are normal receipts. To evaluate these properly, it becomes necessary for the assessor to familiarize himself in hotel operation. He should be familiar with the renting of rooms, the buying of food, employing of waiters, chambermaids, bartenders, bell-hops, orchestras, entertainers for floor shows, etc. The following will indicate some of the difficulties encountered in analyzing such a statement.

Expenses

Salaries and Wages

An item for "salaries and wages" averaged $500,000 annually for the five years. This item increased almost 65 per cent in the five years under consideration, and the question naturally arises: Are these proper and normal charges for the respective years—and why such great increase?

Ground Rent

"Ground rent" set up as an expense was $25,500 per year. This item must be deducted, as the property must be valued free of liens and encumbrances.

Repairs and Maintenance

"Repairs and maintenance" increased from approximately $66,000 in 1934 to approximately $177,000 in 1938. Here is a prolific subject for discussion. Over 10 per cent of the total charges represents repairs and maintenance for the

1938 year. The 1938 charges are almost three times as much as for 1934. Is the assessor supposed to swallow such items hook, line and sinker without challenge? Undoubtedly some of these items will prove to be capital charges and not deductible.

Music

This item increased from $13,000 to $51,000 in four years. What is this for? What kind of music? When played? And where? Is it a normal charge?

Electricity

This item doubled in four years. Was the first year's charge or the last or the average, a normal amount?

Advertising

"Advertising," represented as an expenditure of over $39,000 in 1934, increased to $49,000 in 1939. What is this for? Which sum was normal? Are they justified?

Steam and Water

This item has increased from $24,000 in 1934 to $52,000 in 1938, that is, about 116 per cent. This requires some explaining, some pruning, especially since the *income* increased but 41 per cent.

All Other Expenses

An item "all other expenses," averaged $100,000 per year. What does such an item comprehend? We do not know; but we know it requires an analysis of every item within the classification, and consideration of the propriety of their inclusion in such classification.

Depreciation

Included in the expense items was a charge for "building and equipment depreciation," for the first three years of about $130,000 annually, while for two years it was reduced to $78,000, an average of about $110,000 per year. How much was allocatable to equipment having a personal property status, how much to fixtures having a doubtful status, how much to improvements having the status of real estate, is not shown. What chattel property constitutes fixtures is a question now receiving the serious consideration of the Supreme Court of Ohio. If this depreciation charge pertained to real estate improvements solely, various questions arise. If the depreciation item could be reduced 40 per cent in three years, perhaps because of a longer prospective life, why should it not have been reduced for the former years? This would greatly affect the net income and therefore the resulting value.

Investigation revealed that the depreciation rate taken was 3 per cent annually, based on original cost of about $2,000,000. The 3 per cent depreciation charge is based on an originally estimated life of 33 and one-third years, which would involve the complete charge-off of the main building in 6 years hence, the building being already 27 years old. But the building seems to be well maintained, as good an earner as formerly, and enjoying comparable rentals with the best hotels, and apparently good for many more years of useful life. (Incidentally, the owner recently modernized to capitalize on the post-prohibition cocktail habits, at a cost of approximately $300,000.) It is in a central location and still regarded as the classiest and one of the best hotels in the city.

Since the building is assessed at approximately $1,800,000

and since the life of this building is estimated by the assessor at over 50 years (only 23 years more), a 2 per cent depreciation, involving about $35,000, would have been more reasonable. Thus an expense item for depreciation of $35,000, instead of $110,000, the average depreciation shown for the past 5 years, is more fitted to the case. Such a difference of about $75,000 per year, capitalized at 4½ per cent, creates a possible hidden value of about $1,666,000.

Furthermore, 27 years of depreciation at 3 per cent yearly had been taken, total 81 per cent. Thus only 19 per cent of the original cost had to be recouped over the remaining 6 years of economic life as originally estimated by the owner. If a 50-*year life* originally should have been assumed, but which should more likely be 50 years more from today, whether the unrecovered investment of 19 per cent should hereafter be spread over 6, 23 or 50 years, will require a reduction from approximately $63,000 to approximately $10,000, as against depreciation charges actually taken, averaging $110,000. Bear in mind that an excessive depreciation charge of only $50,000 represents a $1,000,000 value when capitalized at 5 per cent, and a value of $1,111,000 when capitalized at 4½ per cent.

The Department of Taxation of Ohio, similarly as in many states, has prescribed rules for equalized assessments whereby a building shall never, while in use, be depreciated more than 80 per cent. Accordingly, no charge for depreciation would today be permitted, thus annulling a $110,000 annual charge, thereby showing a handsome earnings statement, and a resulting value much higher than the assessment.

The Crux of Every Appraisal

The estimate of future economic life of a building is the crux of every appraisal based on net income. It represents

the difference between a liability and an asset. In a recent case before the undersigned, by using the federal income tax administration allowable rates and economic life, a value of $101,000 was produced; on the other hand, using the Department of Taxation's suggested economic life and rate of depreciation, and the same rate of capitalization, produced a value of over $235,000.

An owner of a 40-year old building who has totally charged off the structure at 2½ per cent may continue to charge off at the same rate although it may still have an estimated economic life of 40 years on the theory that in some of the early years he had neglected to take any depreciation. In other cases, 200 per cent—even 300 per cent—of the original cost may already have been charged off.

Finally, if the owner had set up a sinking fund method of recoupment of investment, even greater reductions in annual expense would be involved and a greater capitalized value result. But here again the battle rages. Is the sinking fund rate of reinvestment to be 1, 2 or 3 per cent, or 6 or 7 per cent, the investor's investment rate usually employed by experts?

Normal Vacancy of a Building

An examination of actual rentals, where an actual income statement is being considered, will require investigation as to whether the rentals are normal, whether the rentals pertain perhaps to an old lease with low rentals about to expire, whether the rentals are misleading in that lessee pays or has paid for repairs or alterations, perhaps for other maintenance charges; whether the lease is on a percentage basis and what minimum rent was received and what, if any, was received on percentage; and, finally: Is

the statement a copy of the books of the corporation? In too many, the round figures betray the phoniness of the figures.

When, however, normal rents are considered, a normal vacancy charge is proper. But what expert can testify from an empirical study of vacancies in the neighborhood under consideration?

Recently, while writing this thesis, there came to my desk a report that the office building vacancy in Chicago office buildings, as a whole, had decreased from approximately 30 per cent in 1934 to approximately 21 per cent in 1939. On the other hand, the Pure Oil Building vacancy, located in the same city, decreased from 50 per cent to 12 per cent for the corresponding period, in other words, from a subnormal to a supernormal condition. Query. Should this building now in 1939 be valued on the basis of its recent actual vacancy, namely 12 per cent, or on the normal vacancy of office buildings in general, namely, 21 per cent? On the other hand, should it have been appraised at a normal vacancy in 1934, namely 30 per cent, when it was actually vacant 50 per cent? Or should the average experience in Chicago for six years for office buildings, or the average experience of that instant building be taken? Here the assessor would have had a fat chance supporting his contention that normal vacancy, namely, 30 per cent, rather than actual, viz. 50 per cent, should control. Here would have come into play that ever ready shibboleth of experts: The building is not developed to its highest and best use, it may be a twelve-story building, but a two-story building would be more economic, the existing structure is obsolete and complainant should be held to the assumed normal income, expenses and valuation of a one- or two-story building.

Unusual Charges

Some of the expense charges are really amusing. One of the charges recently encountered in an expense statement of a hotel was $1,500 for entertainment. Whether this was for wine, women or song does not appear. Is this allowable? Another showed a charge for meals of employes, amounting to over $4,000, when the hotel had already shown all its expenses by way of food supplies, labor, etc., thus showing a double charge for the same purpose. Perhaps it represented some *pâté de fois gras,* Russian caviar, Chinese birds' eggs, or other dainties not served to the honorable guests.

One hotel in its expense statement showed a charge of $4,600 for flowers. Was this allowable? Were they gardenias, roses, chrysanthemums or orchids? And how many, for when? Whether it was a proper charge, whether this involved ordinary or normal charges in the maintenance of the hotel, involves comparison, conference, discussion, and investigations in each case.

Recently the operating statement of an industrial building was submitted showing a net loss of $10,000 for the immediate preceding year. After numerous conferences the company agreed that the repair item for labor and material should have been about one-half of the amount charged in the statement. After final adjustments were made, it appeared that there was a net profit of about $25,000 instead of a loss of $10,000, which profit, capitalized at 5 per cent, represented a value of $500,000. In this connection, the question is very pertinent as to whether industrial concerns like the United States Steel Corporation, which have shown little income for, and scarcely any dividends on, the common stock for the last seven years, are to be exempted from

taxation as to their real estate. The strong position of this stock in the stock market belies any such appraisal by investors.

Capitalization Rate

After the earnings statement is secured by the assessor, after conferences with the owner as to the importance, significance and normalcy of the expenses and income shown, after the normal depreciation charge has been deducted, we still come to the most important problem of all, viz., the capitalization rate. Net income of $40,000, capitalized at 4 per cent, would amount to a value of $1,000,000; on the other hand, a 7 per cent capitalization would amount to $570,000. Experts, working independently, violently disagree as to the proper capitalization rate, which must, in the nature of things, vary with location. A one per cent difference may account for a 25 per cent variation in the appraisal.

After all this is disposed of, the question is still before us: How valuable are our conclusions? We find, for example, real estate experts, with the highest credentials and a lifetime of experience behind them, varying in their testimony from $4,000 to $20,000 per foot of land value, even of well-improved and well-tenanted property in the best section of Cleveland. These experts were probably paid $500 to $1,000 for their opinion and devoted several weeks of earnest study to this case.

If the taxing authorities are to appraise as seriously and contentiously, involving such differences, I shudder to think of the resulting anarchy in the real estate assessing activity. In a county of this size, over 500 high salaried assessors would be necessary. This would represent an extra force, since the income appraisal process is generally checked to

the physical valuation of the building and the market or comparative value of the land. The building residual process of valuation from net income involves as a first step the finding of a land value on a comparative or market value basis. The land residual method involves discovery of the cost of reconstruction of the building as a primary step. Thus we have added a superappraisal based on income, which will topple over if the foundation stones, namely, the physical and market values, are not well footed and sufficiently broad and deep. It would, of course, add tremendously to the administrative cost.

Analyzing the Earnings Statement

The above-considered expense and income statement recites the difficulties of deriving a value as to a single structure where the evidence is freely and willingly presented to secure a tax reduction, for example, before the Board of Revision, a complaint hearing and reviewing body. If such investigation and conference is necessary as to a single building, how shall the assessor secure the data, audit, investigate, eventually challenge and determine the value on net income of 200,000 improved parcels within the short span of perhaps a few months in states calling for a periodic appraisal?

Consider that the assessor must labor first to secure the statement from an authorized representative of the property; secondly, to get it to cover a sufficiently long period of time; then, to eliminate the items that ought not to appear, such as rent, mortgage interest bonds and other improper deductions; to analyze charges for salaries and wages, light and power, fuel, alterations, repairs, insurance, taxes, etc. Then comes the charge and character of management. Is it efficient or inefficient? Does the manager

devote his entire attention to this building? A prominent writer, an M. A. I.,[1] recently listed eleven estimates, involving subsidiary estimates, necessary for deriving a value on an income basis.

The Assessor, *Persona Non Grata*

The difference in relationship between the owner to his hired expert on the one hand, and his relationship to the assessor on the other, must be recognized. The owner freely goes to, and employs, the expert, while the assessor, respectively Revision Board, invites the reluctant taxpayer to submit evidence under threat of penalty. Even so the assessor frequently cannot secure the statement since the taxpayer does not in one-half of the cases live on the property. He likely as not lives in another taxing district, city, county or state. Even when we know his address he may not be home; or, if home, he seeks delay for the convenience of himself, his bookkeeper, his lawyer or his witnesses. Add to this the convenience of the assessor and you visualize some of the delays possibly involved.

But what shall we do about over one-half of the cases when the owner keeps no books, or where the books consist of scraps of paper in his vest pocket, and is able, only approximately, to estimate his receipts and expenses? Or in the thousands of cases where the owner has owned for a few months, a year or two? The grantor is no longer interested. He has scuttled the ship. While all this pursuit is proceeding, time marches on. The necessity for the delivery of the tax list creeps upon us. We cannot wait. The new assessment books must be closed without this direct evidence. Here, then, will be noticed all the difference in entertainment between an invited and an uninvited

[1] Member American Institute of Real Estate Appraisers.

guest. The expert is invited, the employer always at home; the assessor is not invited. When the latter sends a billet doux to the taxpayer with an *R. S. V. P.,* likely as not it is returned post marked "cannot locate."

Conclusion

Appraisal experts with no experience in en masse appraisals for assessments fail to appreciate that their appraisals are not necessarily correlated to other appraisals in the neighborhood. They are secret, made by each expert only very occasionally and for particular purposes, viz., for loan, for insurance purposes, for appraisal of corporate assets, for establishment of a basis for capital gains or losses, for tax reduction, etc., etc. No stranger or public official, except by permission of the employer, knows the contents of any such appraisal. The right hand knows not what the left is doing. Nothing would so prove the uselessness of such appraisals for assessment purposes as a requirement for full publicity of each private appraisal.

On the other hand, most assessors try to relate every appraisal, one with the other, and then publicize them. He must fix a relative value as well as an absolute one. The former is the assessor's goal, the later the expert's aim. Furthermore, he must defend them. He enters his job with an open mind, not interested in getting them high or low. He is not interested in excessive physical depreciation, nor in functional, perhaps technological, obsolescence, nor in outgrown capitalization rates, to arrive at a preconceived goal. To the owner, the expert's appraisal is a Shakespearean poem of exquisite loveliness, finest diction, euphonious rime; the public appraisal, a dime novel of childish fiction and fancy.

When real estate appraisal experts arrive at some definite

formulas for arriving at net income and expenses and interpretation of such figures, some headway will be made toward making income the prime basis of assessment. However, they would soon decry its use as the sole basis, for too many owners of highly improved property appreciate that lightening the burden of underdeveloped and undeveloped property would involve an undue burden to the former.

Some experts freely admit that income should not be the sole basis of assessment, but contend that it should enter more "strongly" in appraisals by assessors. What does this mean? In what degree? Fifty, 75, or 100 per cent? And if diluted with other processes, what emphasis or weight is attributed to each process? Most experts insist, and this is borne out by prominent writers, that net income is the sole, unadulterated and final basis. In my opinion, assessment of real estate of all classes of property based on the income thereof, past, present or future, would never survive a trial anywhere in the United States. It might be attempted in a small taxing district provided the results were not publicized. The assessment of some classes of real estate on the actual net or normal net income (deficit?), while other classes are assessed on a capital value, is not only illogical, but discriminatory and in most states would violate the uniformity required by the state constitution, if not by the United States Constitution.

CHAPTER XV

ALTERNATIVE BASES FOR REAL ESTATE TAXATION

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The purpose of this paper is to suggest a few bases other than capital value and income for real estate taxation and to discuss briefly their merits. This subject is not one on which I have worked as intensively as some of you may have. I am certain that further suggestions and criticisms can be made, I hope in the discussion period to follow. No attempt will be made to deal with legal problems although it should be noted that some of the proposals are probably unconstitutional in many jurisdictions. I should also like to distinguish between the problem of alternative bases, the subject of this paper, and the problem of omissions (resulting from exemptions, loopholes, faulty administration, etc.) from the bases already discussed. Taxes which now touch real estate might be heavier or more comprehensive.[1]

[1] Thus a mortmain tax, similar to some in Europe, on either capital value or some other base might be levied on real estate (as well as other property) which does not pay death or gift tax once every 35 or 40 years. It might be directed primarily at the holdings of institutions whose life span is much greater than that of individuals, philanthropic institutions, perhaps, or business institutions whose underlying assets are in effect taxed when the owners, or creditors, die but which, because of the rules of tax situs, are taxed by jurisdictions other than those in which the real estate is located. Such a tax might, with, it seems to me, better justification, be directed primarily at the holdings of individuals, ordinarily in trust, which for some reason escape transfer tax for one, two, or more generations.

TAXATION OF INCREMENT OR WINDFALLS

One alternative base which deserves serious consideration is the increment in value or windfalls. The two are not the same. Some increments are expected and, being discounted at varying but often high rates because of uncertainty, comprise part of the present value. Expectations often fail to materialize fully, but sometimes the realization far exceeds the expectation (allowing for risk). The excess is a windfall. The term can also include net increases in value due to public expenditure. Future windfalls do not constitute part of the present value.

Historically, of course, the values of land and in some cases improvements, have increased greatly. At the present time in view of both the wars abroad, whose economic effects are obscure but which may resemble those of the last great war, and the huge excess reserves of the banking system and the idle funds of both corporations and individuals, a period of a rising price-level or substantial alterations in relative prices may be ahead. The long-term interest rate may continue to fall, raising the capital value of land; on the other hand, war may raise the rate and lower capital values. Considerable secular growth of the economy can also be hoped for (though the rate of real growth will almost certainly be far below that of the last ten or fifteen decades), and some communities may enjoy rapid development. So far as existing capital equipment and, even more clearly, land and natural resources are concerned, there is no necessity for society to offer the prospect of rising values to secure supplies of these productive agents. Yet if there is a substantial rise or readjustment of prices, the owners of this property will be able to command a higher price for its use. It can be argued with good reason that, while tak-

ing some or all of this increase in value in taxes will, of course, leave the owners less well off than if there were no tax and, if the tax is not confined to windfalls, will take part of the investments for which they have sacrificed, a tax on the increment should not impede economic adjustment or raise the costs of production. The owners, unlike the frontiersman breaking new ground or the businessman pioneering in new economic realms, play no part in producing the extra value. The increment is the result of broader social economic forces.

The case for taxing this increment is essentially the case for taxing excess profits,[2] except that the relatively fixed supply of land may make the case for the tax on land increment even clearer. The tax would be primarily on the type of income rather than the economic status of the recipients; it is thus similar to most property taxes and nevertheless a defensible exception to traditional ability-to-pay standards. It should be clear, however, that though a tax on existing improvements only will not decrease the supply, the government might find it impossible to convince investors that a similar tax will not be introduced again and applied to replacements or maintenance expenditures. With confidence weakened, they will consider the risks greater and demand a somewhat larger return, thus increasing the costs of capital for improvements. Another theoretical difficulty is that equity would require some accounting for the change in the value of money. The real increment as contrasted with the nominal increment in dollars should be the base for the tax. Thus, if values are falling,

[2] For a brief discussion of the case for and against excess profits taxation see Carl Shoup and Associates, *Facing the Tax Problem*, pp. 271–90, 555–61, and C. Lowell Harriss, "Monopoly and the Excess Profits Tax," *The Tax Magazine*, XVI, 717 ff.

but some less than others, there may in a real sense be an increment. The difficulties of discovering and applying an index of prices are not minor, but Germany seems to have done so during the inflation.

Under present circumstances the revenue would probably be relatively small, but under conditions which may conceivably develop it could become important. Its successful operation would, however, raise serious problems.[3]

Initial valuations, from which to measure the increment, would have to be placed on the property. The present valuations might be used even though they are inaccurate and not uniform. The tax would then be on the difference between the present assessed valuation (with some allowance perhaps for subsequent adjustments) and the value at some later period. The tax on the difference would then take not only part of the true economic increment but also recoup, very unevenly, some of the taxes escaped in the past because of undervaluation.[4] If such recoupment were an object or a result of the tax, then to be equitable the tax should vary with the length of the period of underassessment, the variation in tax rates and valuations during that period, the rate of interest, compounding, etc. Accurate

[3] The famous Lloyd George budget of 1910 included a tax of 20 per cent on land increment. For a discussion see Yetta Scheftel, *The Taxation of Land Value*, especially Chapter V; also R. B. Yardley, *Land Value Taxation and Rating, passim;* also E. R. A. Seligman, *Essays in Taxation*, pp. 488–496. Both Scheftel and Seligman have extensive bibliographies. In Germany land increment taxes have been used with varying success since early in this century; the reader is again referred to Scheftel and Seligman and also to R. C. Brooks, "The German Imperial Tax on the Unearned Increment," *Quarterly Journal of Economics*, XXV, 682 ff. For illuminative discussion of certain aspects of the problem see Edwin H. Spengler, "The Increment Tax Versus Special Assessments," *Bulletin* National Tax Association, XX, 258–61; XXI, 14–17; 163–7; 240–4. *See also* Mabel L. Walker, *Urban Blight and Slums*, pp. 271–8.

[4] The real merit, if any, would be not removing the defects of undervaluation per se, but rather in rough measure offsetting the discriminations due to unequal undervaluation.

adjustments would seem insuperably difficult, especially if the tax were also to take the economic increment regardless of when it accrued. If sufficiently high, the tax might be of some use in reducing the desire for underassessment.

A general valuation when the tax is introduced would probably be necessary.[5] The establishment of the tax, unless it were accompanied by an equivalent reduction in other taxes on real estate or unless it were somehow confined to windfalls, should depress present values. This would reduce the base from which the tax starts (with some effect on the yield of the existing capital value taxes), but it should not affect greatly the amount of the increase in value, the base for the increment tax. It would, however, reduce or eliminate that part of the increment which is the capitalization of the expectation of future increase. It would be obviously difficult to reach windfalls only. The closest approach to accuracy and equity would be secured when the values just before the introduction of the tax were used, thus including the discounted value of expected increments. In practice the results would fall far short of the goal. Separate valuation of land and improvements would be required together with careful accounting of net depreciation, depletion, and investments during the period. While the difficulties would not be insuperable, they would be great.

Equally difficult would be the problem of subsequent valuation. The tax might be levied periodically at stated intervals. If the intervals are uncertain, the choice of dates

[5] Nearly 8,000,000 parcels were valued for the British tax at an estimated cost of about $25,000,000. Nearly 10 per cent of the valuations were in dispute when the tax was abolished in 1920. Total collections had been about $2,300,000. The valuation problem in this country would probably not be correspondingly great because of the regular assessments. For the British data see Yardley, *op. cit.*, *passim*, and pp. 183 and 269.

will be subject to political manipulations; a temporary rise in values could be chosen as proper occasion for the tax, or a government under the influence of owners of real estate could repeatedly postpone the tax. If stated intervals are used, temporary changes due to cyclical movements may reverse or obscure the more permanent effects. The longer the period chosen, 15 or 20 years, the greater the probability of securing the true increment (shorter periods would have to be used for improvements whose economic life is shorter), but, on the other hand, the longer the period the owner is allowed to enjoy the yield of the increment. The difficulty of valuing specialized equipment, such as factories, land owned by business firms, etc., is obvious.

If the tax applies only when the property is sold (and does not apply to all types of property), it can be avoided by failure to sell or can be postponed indefinitely. Furthermore, large amounts of property are held by corporations or families which need never sell; if intangibles are not taxed, incorporation may offer a simple way to avoid the tax.[6] The problems of uniform and equitable treatment would be greater than under the capital gains tax both because of the exemption of certain property and because declines in value might not be allowed as offsets. Offsets for declines in the value of land and perhaps existing improvements might not be economically imperative, but failure to allow deduction of declines on improvements made after the tax is put into effect would increase the risk of such investments and increase their cost. Allowances for carrying charges on unimproved or underimproved land should probably be made. The problem of allowing equitable de-

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[6] Seligman (*op. cit.*, p. 512) says that in Germany sales of the securities of a corporation are considered to be sales of the aliquot part of the real estate, but he gives no indication of the success of this provision.

ductions for a tax *in rem* rather than *in personam* seem almost insuperable. Using sales as the test also raises the question whether transfers by gift or bequest are to be treated as sales; if they are not, avoidance of the tax by some owners becomes relatively simple.

It should be noted that there would be greater incentives to contest valuations for an increment tax than for present real estate taxes. The increment tax would ordinarily fall only on the values within the range of dispute rather than on the whole value. Thus, when there is a tax of 2 per cent on capital value and there is question whether the value is $80,000 or $100,000, the tax on the difference is only $400 a year, about 20 per cent of the total tax. If, however, there is a tax of 20 per cent on the increment and the value set for the base year was $70,000, the increment tax is $2,000 if the later value is fixed at $80,000 and $6,000, three times as much, if it is fixed at $100,000.[7]

Securing liquid funds for payment of an increment tax may be difficult. To the extent that the tax is levied only when property is sold, the question of liquidity will not be serious,[8] but a tax so levied will, as pointed out above, reach only a part of the total increment which, it would seem, should be taxed. If the tax falls at stated intervals not associated with sales, there may be real problems of liquidation (the effect of the necessity of liquidation will be reflected in the value); if the tax falls on real estate at the

[7] The annual tax of 5 per cent of the increment suggested by Spengler, *supra*, note 3, would equal approximately 100 per cent of the capital value of the increment. Placing the tax on an annual basis has one advantage, however: there would be no tax in years of depressed values.

[8] One of the purposes of the German taxes was to check speculation. The tax seems to have had little effect on the volume of sales, but it seems to have increased the expense of some mortgages, chiefly second mortgages, because in some cases the increment tax constituted a prior claim to the proceeds of foreclosure. Scheftel, *op. cit.*, pp. 177–184.

same time, the difficulties will be accentuated. On a rising market, sales without undue sacrifice may not be difficult. The problem of liquidation should not be made determining, however, because adequate notice can be given, permitting the owner to save for the tax, and time for payment can be allowed at reasonable rates of interest. Another problem is how to treat holdings which are broken up or combined.

In spite of the difficulties, however, there is so much to be said in favor of the proposal that its adoption in some form can be recommended for many communities.

Taxation According to Acreage

Another possible base for real estate taxation could be area, so much tax per acre regardless of value or with arbitrary adjustments for value. Such a base could be justified where the land is of uniform value or if the tax is too small to justify the cost of assessment or to finance services on a cost basis where cost is predominantly determined by area.[9] Such a tax would resemble special assessments and would raise some of the same problems. A tax on area, perhaps superimposed upon one on capital value and disregarding debts, and made progressive with the size of the holding might be used to help break up large holdings of a person, family, or a corporation. The tax could progress with the total holdings within the jurisdiction or in one plot. It would be predominantly for redistributing land (as might be desired), not redistributing wealth. As a measure of ability it might be better than nothing but obviously leaves much to be desired. It might misdirect production, bring-

[9] Thus, British Columbia has an acreage tax for financing the destruction of insects. Australia has a similar tax. Taken from *Tax Systems of the World.*

ing under cultivation land which should be left for grazing or which could be farmed more profitably on a large scale. If the government wishes to reduce the number of small holdings, perhaps because they are relatively uneconomical, the tax might be made degressive, the smaller the area the higher the tax rate.

A tax on capital value, income, or increment might be graduated according to the total holdings either within or outside the jurisdiction.[10] The considerations discussed in the last paragraph would apply generally. In addition is the fact that corporations may require large holdings for efficient operation.[11]

Cost of Service Basis for Taxation

What alternative bases for taxing improvements can be suggested? Taxing increments in value has been discussed above. Another possibility might be some kind of a charge

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[10] For many years Australia and New Zealand have had such taxes. *See* Scheftel, *op. cit.*, Chapters II and III. The purpose was largely to break up the large estates. The success has been only moderate, avoidance and evasion being relatively easy. The tax is higher if the owners are absentee. Ecuador and the Netherlands also have property taxes progressive with the value of the holdings. *Tax Systems of the World.*

[11] Other possible taxes or illustrations of those already discussed suggested by an examination of the summaries given in *Tax Systems of the World* are: a tax of 4 per cent levied every five years on the increase in value of the land and also a tax of 25 per cent of the increase in value due to railroad development in the region, Denmark; a tax as high as 2½ per cent on the selling value of land, depending upon the length of time the land has been held, the former Free City of Danzig; a graduated tax on land reserved for hunting or a tax of as much as 15 per cent of the increment due to public expenditures or growing population, the tax not to exceed 30 per cent of the expenditure, Italy; a tax varying according to the relation of the income to the capital value, Sweden; a tax based on the values of some former period, a method used in certain German states which apparently use pre-inflation values for computing present taxes; a tax of 5 per cent on the "unearned increment" of land when transferred, Alberta; a tax on land which has not been improved, British Columbia; a tax on the acreage of wild land when more than 500 acres are owned, New Brunswick.

for services rendered.[12] The object would not be to make it possible for owners of property to go without services now financed by taxes and which the community wants everyone to have but rather to adjust the charges on a different basis, that basis being, presumably, costs which can be allocated to the property. The charges would tend to be passed on to the users of the property.

For example, cubic contents, number of rooms, height, type of construction or use, street frontage, location, etc., might be more logical bases for apportioning some taxes than value. Such criteria are, of course, often taken into account in determining assessed values now; one advantage of using them is that they can often be determined with objective accuracy. At present, however, the result may be that a new building of the best construction and planning may have a higher value and hence a higher tax than an old building whose costs to the community are much greater. The costs of providing education, for example, may depend more upon the cubic contents and use of a building than upon its capital value or the income it yields. A business with noticeable seasonal or cyclical fluctuations in employment with consequent demands upon society for relief of its workers will be more costly than one with equal investment but steadier employment. Similarly, businesses with undesirable industrial wastes may impose upon the community costs quite unrelated to the value of the property. New industries absorbing the unemployed may relieve the community of relief expenditures. In other words,

[12] Proposals bearing some superficial resemblance to this are advanced in *Unified Government and Tax Reform for Los Angeles County,* General Study No. 4, Los Angeles Bureau of Municipal Research, Incorporated. The general program varies greatly from one I should support. Rumania levies a tax per square meter (of floor space, it seems), per inhabitant, per frontage, and according to the insurance premium, for fire protection. *Tax Systems of the World.*

the cost of the services which the community renders or which it makes because of the existence and nature of the property bears no necessary relationship to either the value or the income of the property.

Consequently, allocating the total cost on the basis of value means that some property or owners or users of property will bear less than their economic share of the total costs and others will bear more. The result will be a less than optimum economic utilization of resources. Improvements whose costs to the community are greater than their costs to their owners continue in existence while new investments are not made even when the social advantages would warrant because the money costs are too great.[13]

The cost of service basis for taxation is neither new nor untried. In any discussion there is apt to be confusion between the relative desirability of imposing taxes directly on things or on persons. Here, it should be made clear, the suggestion is not to displace a tax on things by a tax on persons or even to tax improvements on an ability-to-pay or benefit basis but rather to allocate the taxes not according to value but on a basis which might lead to better utilization of economic resources. Some groups obviously cannot pay for the services they receive; subsidies are necessary. The present method of subsidizing, however, by placing extra taxes on more valuable property would seem to lead to economic distortions which might be reduced.

Here, again, however, the administrative difficulties might be overwhelming. They certainly would be if perfection is insisted upon, but they might not be if the goal set is some reasonable improvement on the present situa-

[13] Some but not all of the economic objectives of the proposal being made could be secured by valuing all improvements on an undepreciated basis, i.e. allowing no deductions for depreciation.

tion. Accurate allocation of costs is impossible, but some acceptable results are not beyond hope. Serious difficulties would arise in allocating overhead costs, those already incurred and those to be incurred; the present method of allocating according to value, however, is far from ideal economically.[14] What portion of the total costs for education should be borne by residential property and what portion by business property? How should existing taxes which may have been capitalized be treated? Should the proposal be applied only in the case of new taxes or extended to existing taxes? How easily can adjustments to the new conditions be made? Obviously, such problems cannot be easily solved, but they indicate some of the practical difficulties of applying a program which seems logically desirable.

In conclusion I should like to say that I cannot become enthusiastic over any of these suggestions. The theoretical arguments in their favor must be countered by the practical difficulties of administration. Yet there does seem to be sufficient merit to two of the proposals to justify further serious study; one of the two is to tax windfalls in the value of land, the other is to tax improvements, to some extent at least, on some sort of a service charge basis.

[14] The marginal cost of new improvements to the community might be very low, in the short run perhaps even negative. From this fact stem arguments for freeing new improvements from taxation—to stimulate building perhaps. There is certainly much to be said for some of the proposals. Owners of existing property would tend to suffer not because of increased taxes necessary to provide services for the exempt buildings but because the increased supply of facilities will tend to reduce the rents on the older property.

PART FIVE

ADMINISTRATIVE PROBLEMS OF PROPERTY TAXATION

CHAPTER XVI

IMPROVEMENTS IN PERSONAL PROPERTY TAX ADMINISTRATION

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THERE are three basic duties to be performed in the assessment of personal property. First, the administrator, whether a local or a state official, must discover the existence of taxable property; second, he must find out who owns it or who is liable for any tax levied by reason of its existence; and, third, he must determine how much the property is worth. The discharge of this threefold duty is called the assessment process. There are at least five requisites to its successful discharge. First, the organization created for the task must be designed in accordance with sound principles of administrative procedure, because the task is essentially, if not exclusively, administrative in character. Second, the organization must be staffed with a sufficient number of competent persons, working under conditions that insure a high morale. Third, this personnel must have available to it the equipment which is necessary for the proper utilization of their skills. Fourth, duties imposed on the organization must be reasonable and accompanied with adequate legal power to discharge them fully. Fifth, the organization must be using the most effective techniques that have been discovered and must be constantly engaged in the search for new and better ones.

I do not believe I am telling any secret when I say that, so far as personal property is concerned, there is no jurisdiction to which I could point which possesses all five of the requisites which I have just named. As a matter of fact, only a few have even one or two of them. The conclusion is inescapable that efficient personal property tax administration simply doesn't exist. Likewise, it is the opinion of most competent observers that it never will.

At this point, I suppose I should follow the usual practice and recite some statistics, incidents and items that would illustrate how bad personal property tax administration really is. However, I am not going to do so. It would be a mere waste of time. I daresay that every bit of evidence I could submit on this score could be matched or exceeded by nearly every person in this audience, either from his own study or from personal experience. I believe this paper will have more value if we skip the evidence and, as a lawyer might put it, agree to the stipulation that personal property tax administration is pretty sour. So what?

Before we proceed to drop the personal property tax into the ash can, there are a few things for us to think about. In the first place, the tax does produce revenue on which many jurisdictions still depend for support.

Revenue Significance of Personal Property

During the year 1938, it is estimated that property taxes accounted for approximately $4,745,000,000 of governmental receipts. In a recent report prepared by the Bureau of the Census, the total assessed valuation of all property, real and personal, subject to general and selective property tax levies during the year 1937 was listed at 139 billion dollars. Of the total, nearly 22 billion, or 16 per cent, was represented by personal property. If you will permit a few

liberties with sound statistical analysis and ignore for the moment such variables as assessment ratios, tax rates and proper classification, the above figures tell us that the revenue from taxes on personal property in 1938 was somewhere in the neighborhood of 750 million dollars. This is a lot of money. It is not much help to point out that personal property tax laws are a farce, that they never were properly administered and that they never can be. All this has been said over and over again until most of us are sick of hearing it repeated. It has been said so often, and there is such a mass of evidence to support the statement, that it has long since been accepted without argument. The natural and logical conclusion is that the personal property tax should be abolished, at least in many of the forms in which it exists today. Parenthetically, we have also learned not to expect a great deal of logic in the organization of governmental processes, and especially is this true in the tax field. Tax policies are not based on logic. They are invariably the result of compromise between numerous conflicting selfish interests, and the policies eventually established always reflect the weight of the different pressures that have been applied in creating them.

So long as we don't expect any rigid application of logic in framing our tax policies, we are forced to the conclusion that the reforms which we have in mind and concerning which many competent authorities have written extensively are not going to be fully installed for many years—if at all. And we still have those 750 million dollars to worry about. They are not going to be surrendered until replacement revenues are at hand, regardless of the inequities and inefficient practices involved. Any attempts to settle upon the type of taxes that shall be used for replacement revenues are likewise open to the application of all the various

pressures that are frequently the cause of many of the defects in the existing administration of the property tax.

And so we are faced with this situation. We are aware of the deficiencies, both inherent and acquired, in present personal property tax administration. But we also know that, in spite of its defects, it does produce revenue for local and state governments to the extent of about 750 million dollars annually.

Possibility of Improved Administration

Thus, insofar as the improvement of the situation is concerned, two distinct avenues of solution suggest themselves. The first is positive and the second is negative. Both are being tried, but only the second appears to be promising.

The positive approach encompasses all the effort being made to improve the quality of the administration of present personal property tax laws by local assessors. The negative approach will include all the effort to diminish the legal personal property tax base or to transfer the assessment to a state agency.

Let us first take a look at what is happening by way of improvement of local administrative practice—either actual or attempted. At the outset, I mentioned the five requisites to good administration, namely, a well-conceived plan of organization, skilled personnel in sufficient number, adequate tools and equipment, responsibilities within reason attended with legal authority sufficient for their expeditious discharge and the application of efficient techniques. If we adopt these criteria as yardsticks, we are forced to admit that recent improvements in personal property tax administration are characterized more by hope than reality. Certainly there is no lack of viewing with alarm, coupled with sound and strong recommendations by state tax commis-

sions, tax study commissions, associations of citizens, association of public officials, writers and others. It is probably within reason to believe that there are at least 100 strong recommendations for each progressive step actually taken.

Cooperation of State Tax Commissions

When we examine those changes in organization which were made in the interest of better local administration, one development stands out quite prominently. I refer now to the policy of close cooperation with and practical assistance to local assessors by state tax commissions. Until a few years ago most state tax commissions and local assessors seemed to be about as friendly as a couple of Kilkenny cats. Supervision duties of the central agencies were characterized by the big stick of the overlord rather than helpful advice from the wise counsellor. In a large number of states—and this number increases each year—this policy is becoming as obsolete as the kerosene lamp. In the progress of this metamorphosis, the Wisconsin plan of supervision enjoys considerable popularity as a model. As most of you know, the state of Wisconsin is divided into 10 supervisorial districts.[1] In each district there is a permanent office in charge of a supervisor of assessments. Each supervisor is an employee of the state government and is appointed by and responsible to the state tax commissioner. They have two major functions. First, to secure the data which form the bases for county and state equalization; and second, to confer with, advise, assist and supervise local assessors to the end that the original assessments made by local assessors will be as equitable as possible. As

[1] Under a reorganization plan, which became effective on April 1, 1940, the number of districts was reduced from ten to four. The entire supervisory staff was reduced from 33 persons to 20.

should be expected, the assessment of real estate occupies the largest portion of their time, but they have also been extremely useful in improving the assessment of personal property. Last year both Maine and Arkansas established supervision organizations that greatly resemble the Wisconsin idea. Other modifications of it will be found in Massachusetts, Colorado, Illinois, New York, California, Washington and Mississippi. A few tax commissions have found it possible to prepare manuals for the guidance of local assessors. An excellent job in this respect has been done by the Illinois Tax Commission, which has published and distributed a personal property manual which is quite comprehensive and extremely instructive. If all tax commissions could install an adequate supervisory organization, prepare and distribute instructive manuals, and then supplement both with periodic training programs for local assessors, considerable improvement in personal property administration should be the result—although, because of the presence of other factors, it is certain that even then completely satisfactory administration would hardly be achieved.

Reorganization of Assessment Offices

Reorganizations in local assessment offices for the purpose of improving the quality of personal property assessments have been extremely rare. Such as did take place were part of a general plan to change the entire office from a geographical to a functional pattern. The Detroit office made this shift about two years ago and the new plan in Philadelphia specifically divides the personnel into two groups—one for personal property, the other for real estate. These are the only ones that come to mind which seem worthy of notice, but it should be pointed out that the membership

of the National Association of Assessing Officers is on record in favor of the functional plan of office organization.[2] This type of organization is relatively common in larger jurisdictions where the office is in charge of one person; but where a board is in charge, work is usually apportioned on a geographical basis. You can add this to the other arguments against the board plan.

Personnel

Neither has there been any substantial progress along the personnel front. Of course, it is true that a number of assessment jurisdictions select subordinate personnel under civil service systems. Such jurisdictions are almost exclusively agencies of city governments, although there are some county assessment offices where this is also the case.

About the only places where the heads of assessment offices are selected on the basis of merit are in those cities using the council-manager plan. With a few exceptions, the assessors in other jurisdictions are either elected by popular vote or appointed by some official or agency restricted only by the probable political consequences of the appointment. I don't want you to misunderstand me. I don't mean that there are no competent assessors in these two latter groups, simply because they are elected to office or did not have to have their qualifications tested before appointment. On the contrary, this group includes many of the outstanding leaders in the field. A notable example is John A. Zangerle, who has been elected and re-elected in Cuyahoga County, Ohio for the past 25 years.

The condition I have just described has remained about the same for the past few years. The only real progress is

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[2] National Association of Assessing Officers, *Assessment Principles*, 1939, p. 30.

in the field of thought, and I sincerely believe that there is a constantly increasing recognition of the need for trained and competent personnel. Not only is this true of the public in general, but likewise among the more progressive assessors. The NAAO Committee on Principles of Assessment Practice has flatly recommended that "the assessor should be appointed from among candidates certified as to fitness by a competent and impartial agency." [3]

Equipment

Adequate equipment is not the problem in the assessment of personal property that it is in real estate. To do a good job in the latter field, it is absolutely vital to be well supplied with accurate maps, property record cards, building classification and cost schedules, etc. The equipment necessary for personal property would be the regular list of ordinary office furniture and supplies, plus proper forms for recording essential information and space for filing it. However, when the volume of work is large, the use of mechanical addressing equipment is almost indispensable if extensive use of personnel is to be avoided. I believe most offices are fairly well supplied with the ordinary requirements, but there still are thousands of districts which have about one desk and a filing cabinet. Frequently, the only records consist of the returns filed by taxpayers.

Authority Commensurate with Responsibilities

As we all know, assessors have always been handicapped because their authority was not commensurate with their responsibilities. As an example, many states require the assessment of bank deposits to the depositors, but then pro-

[3] *Ibid.*, p. 19.

ceed to withhold from the assessor the authority to demand a list of the depositors from the bank, which is the best and most obvious source of information. I recall a few years ago that a bill sponsored by the West Virginia County Assessors' Association sought this privilege, but it was promptly killed when the banking interests protested that if lists of depositors were made available to the assessors, the assessment of deposits might follow, and if that took place the deposits would promptly be removed and redeposited in banks in other states. If the legislature believed this, it should not have stopped at killing the bill making the lists of depositors available; it should also have repealed the act making the deposits taxable—instead of being content to leave the assessors hanging on the end of a limb. I regret to state that the legislative policy mentioned above has changed but little in recent years. There was one measure adopted in Oklahoma, however, that would be a good model for other states. In the new intangibles act adopted last year, there is a provision that denies any judicial remedy to the owner of any taxable intangibles until he submits evidence that they have been assessed and the taxes paid. A few other states have somewhat similar provisions, but with this important difference: Oklahoma puts the burden of proving the assessment and tax payment on the taxpayer, while in the other states it is usually the duty of the defendant to disprove it.

Other Considerations

Probably something should also be said about the Costigan Amendment, although this measure is nearly five years old. It was intended to make federal income tax returns available to local assessors, where they would be especially valuable in the assessment of intangibles but also useful in

checking assessments of such tangibles as would be included in business inventories. However, through an interpretation placed on the act by the Treasury Department, accessibility is extremely restricted. Where the federal income tax returns were made available, the assessment of intangibles rose sharply.

Even in the field of technical procedure it is difficult to find any substantial improvements. Perhaps some of these are worthy of mention. Before doing so, it should be emphasized that one of the most important obstacles to effective personal property assessment is the fact that personal property has so many forms and uses. A technique which may be extremely effective for one type may be quite useless so far as other types are concerned. This means that it is almost necessary to have a special procedure for each type of personal property, whether tangible or intangible.

In those places where intangibles are still required to be assessed by the local assessor, there are two noticeable forms of improvements. The first is more extensive use of public records. This includes the use of federal income tax returns, state income tax returns, the corporation statements filed with the Securities and Exchange Commission, and those filed with state agencies. Progressive assessors have long since gotten over the naive belief that returns of taxpayers can be relied upon without checking every available source of information.

Another development not without significance is the growing spirit of cooperation among local assessors on the matter of exchanging information. This is true on both an intra- and interstate basis. Several states now require intrastate cooperation as a matter of law, but we also have records of numerous examples of interstate cooperation which

is absolutely voluntary. It should be added that this is common practice among members of the Association which I represent and is something that is encouraged as much as possible. This exchange of information is useful in the assessment of tangible as well as intangible property. Where they can get their hands on them, assessors are also making much use of so-called confidential reports filed by individuals, firms or corporations when seeking credits.

Administrative Problems in Assessing Tangibles

In many respects, tangible personal property is less adapted to standardized treatment than are intangibles. Consider the variety of types of tangible personal property: household furniture, business furniture and fixtures, motor vehicles, livestock, merchandise stock, goods in process, raw material, farm machinery, factory machinery, tools, equipment, etc., to mention only the most important classifications. And every one of these classifications could be subclassified almost without end. It is apparent that it is almost necessary to have a specially trained man in the appraisal of each class, which you will readily admit is impossible except in the largest assessment jurisdictions.

I have mentioned the personal property manual prepared by the Illinois Tax Commission. A few other states have also undertaken this task, but the effort doesn't display the same degree of thoroughness. Yet, they probably have been the means of some improvement.

The problem of assessing the stock of merchants is partially being solved by adopting the average inventory instead of the inventory as of the assessment date. Eighteen states now follow this method and it is being advocated in many of the others. Utah, however, repealed such a law in

1939, because, according to one of the assessors, it was resulting in more effective assessments. There is also a trend toward the establishment of a uniform assessment date throughout the nation. January 1 is now used by 19 states and is being recommended in others. Connecticut requires that watercraft be registered with the local assessor instead of the clerk, and many of the states still levying property taxes on motor vehicles require registration lists to be furnished local assessors. Some go even further. In a few cases, the assessor handles the distribution of state license plates and in others the owner must present his property tax bill before he can secure his plates.

Household furnishings were never satisfactorily assessed for two reasons: first, because assessors are reluctant to enter homes for the purpose and, second, because the variety almost defies any attempt accurately to appraise it. One short cut which seems to meet with increasing approval is to value the furnishings at a percentage of the value of the house which contains them. On the other hand, the trend is definitely in the direction of either exempting household furnishings outright or else increasing the amount of the exemption so as to exclude from assessment all except that contained in large and expensive dwellings.

Other improvements which might be mentioned include use of the radio in securing better response from taxpayers in the filing of returns, the employment of specialists in personal property divisions, greater use of the field canvass, and the development and maintenance of better record-keeping systems. However, these improvements are definitely sporadic and for reasons already indicated have probably contributed only a little to general improvement of personal property tax administration.

Trend to Exemption of Intangibles

So much for the so-called positive improvements. It is the improvements of the negative variety that have commanded the most attention and produced the most effective results in recent years. So far as intangibles are concerned, there is a definite and strong trend either to exempt them entirely or reduce the tax and turn administration over to a state agency, usually the state tax commission. Within the past two years, North Carolina, Georgia and Michigan were added to the list of states in the latter category, which left only nine states still maintaining the fiction that intangibles are being adequately assessed under the general property tax. Nevada will vote next year on a constitutional amendment to prohibit any property taxes on intangibles. In 1938 the Arizona Supreme Court held the assessment of intangibles was illegal for the very strange reason that they had not been previously assessed and that failure to assess over a long period had nullified the act creating the tax liability. Theoretically, state administration is much better than local administration of intangibles; and in the states where the shift has been made the evidence is fairly substantial that improvement did take place,[4] but not to the degree which most advocates predicted.

At the present time there is a great amount of personal property, tangible and intangible, assessed by state agencies, under many different schemes. Where changes do occur, the trend seems to be still in that direction. Last year Arizona and Arkansas transferred to the state tax agency

[4] National Association of Assessing Officers, *The State as an Assessment District*. 4th Progress Report of the Committee on Assessment Organization and Personnel, p. 46.

the responsibility for the assessment of all property of pipe line companies, while Louisiana decided to have the state tax commission assess the property of chain stores.

Delaware finally repealed all laws imposing taxes on personal property, but this was only legal recognition of a condition that had existed for years. In Cook County (Chicago), the assessor not only adopted but publicly announced his adoption of an extra-legal classified personal property tax scheme and it seems to have met with pretty general public approval. No sanction for it can be found in any Illinois law, but he justified it on the basis of existing tax competition in other states. Another important part of his administrative policy is the total exemption of all personal property below $400 in value, justified by the assessor on the ground that the expense of collection of small accounts often exceeds the tax collected.

Summary

Time does not permit me to describe in detail the changes mentioned above. However, I think I have given you a brief outline of the type of changes which indicate the direction in which the work of improvement is moving. Obviously, the strongest movements are in the direction of the abolition of personal property taxes in the present form or transferring the assessment of intangibles and certain types of tangibles to the state tax agencies. They are probably the strongest because they are the most logical, and while logic doesn't seem to count for much in framing tax policy, it is a pressure that is always present.

In the other direction are the improvements in local assessment offices. These attempts are inclined to be a little half-hearted, because most assessors are of the opinion —shared by many authorities—that they are charged with

duties which cannot be performed no matter how hard they try. They get a bit tired from always being obliged to swim upstream in a current which moves faster than they can swim. In countless local assessment offices serious effort to assess personal property, especially intangibles, was discontinued years ago and there is not much hope that it will be revived.

Two states, New York and Delaware, have already completely abandoned taxes on personal property, and it will occasion no great surprise when other states proceed to do the same. But so long as something like 750 million dollars are involved, this change is not going to take place overnight.

CHAPTER XVII

IMPROVEMENTS IN REAL ESTATE ASSESSMENT TECHNIQUES

WALTER W. POLLOCK

President, The Manufacturers' Appraisal Company

AFTER forty years of experience as a professional appraiser, during which time my business associates and I have assisted nearly 100 municipalities in revaluation of taxable real estate for assessment, I am convinced that the prevailing inequity in assessments of real estate is due primarily to confusion of thought as to concepts of value; and in the second place to failure of the laws to require assessors to use systematic processes of appraisal, which would record for each real estate property the value due to each element or factor of value—under which the value of the whole property would be shown to be the sum of the values of all its value-elements. Of course, some of the assessment shortcomings are the result of placing non-technical assessors in office, and some to conscious favoritism.

LEGAL DEFINITIONS OF VALUE

Legal definitions of value in the several states comprise expressions of the ethical thought that assessments shall be "fair"; that they shall, as required by the constitution of Ohio, be appraised at the "true value in money"; that they shall represent the value which a willing buyer who is not obliged to buy shall pay a willing seller who is not obliged

to sell; or that property shall be appraised for assessment at "market value." All of these legal attempts at definition imply equity and proportion in assessments, based upon valuation, but there is no law with which I am familiar under which an assessor is required to consider that the problem of valuation throughout his district is one to be solved for all properties by a uniform system of value-analysis. The nearest legal approach to such a plan is Rule 14 of the Illinois State Tax Commission promulgated in 1927 in an attempt to correct the notorious inequities in Chicago real estate assessments. This administrative rule describes the requirements of a process of equitable valuation; and not until the several states, or administrative bodies charged with responsibility for assessment valuations shall enact and enforce such rules of appraisal may we hope for general improvement in the equity and proportion of real estate assessments.

"Fair" value as a statutory requirement is merely an ideal, a motto expressed as a guide for the assessor. This ethical admonition by itself has no merit as a rule of judgment or computation. An assessor may have every impulse toward "fairness" and at the same time have no way of linking this impulse to technical solution of his problem.

"True value in money" is another worthy ideal which creates confusion rather than enlightenment for solution of the assessor's problem, and opens the way to endless futile arguments and fine-spun legal decisions.

The willing-buyer-willing-seller legal maxim is a legal fiction, for there are few "willing" buyers or sellers in relation to a specific property at an agreed price. Buyers always hope to buy at low prices, and sellers expect the highest possible prices. If there should be agreement upon a given price it will usually be found that the necessities

of buyer or seller, or both, rather than the price itself will be the cause of a compromise agreement.

"Market" value as applied to real estate is a misnomer, if applied to the valuation of a property comprising land and buildings. The proper use of market price is in connection with a uniform quantity or weight—as for a yard of cloth or a pound of butter. A real estate parcel comprises several value-elements—frontage, depth, corner, alley, transportation facilities, etc., with varying influences upon valuation. The true "market value" for a lot of land is the unit-foot price which represents opinion or judgment, which may be applied to all similar lots, of the value reflected to a unit quantity of land by single street accessibility or usefulness. It is possible by this process adequately to appraise and compare the location-value of a city lot in Philadelphia with a similar lot in any part of Philadelphia or in any other city. Likewise, every building valuation is a conglomerate of many value-factors of construction materials—foundations, steel, concrete, brick, roof, interior finish, stairs, painting, etc. For assessment purposes the true market price of a building is the unitary cost per cubic foot of content or of ground area, or of square-foot-of-floor-space area, less losses of usefulness due to mechanical deterioration, obsolescence or lack of utility. There are many real estate appraisers who say that you cannot add land and building valuations of a specific property to determine the value of the whole, but that is because they do not properly analyze the losses of value in buildings due to depreciating causes.

System of Comparative Appraisal

Most assessors understand that if they permit great disparity in valuations of identical properties in a neighbor-

hood they are likely to promote appeals; but without the compulsion of law or adequate technical qualifications they hesitate to undertake revaluation of real estate in a whole community with the principle in mind of relativity and proportion as between all properties. This cannot be done without first adopting a system of comparative appraisal, preferably supervised by expert technicians. The human mind has its limitations in comparative valuation, and if equity and proportion are to be accomplished the assessor must use judgment or opinion for appraising primary unitary factors, and must devise or adopt mathematical formulas for computation of the value-effect of variable factors. He needs expert advice and direction to audit by systematic processes the valuations of taxable properties for assessment, just as expert advice and direction is required for installation of a cost accounting system, or for the design and construction of a public works system. The systematic assessment will be equitable for all properties. This will certainly be true "fairness" and the valuations may be tested by the conventional value-concepts so far as applicable. In order to be appeal-proof, except for discoverable errors in unitary pricing and computation, the valuations should be submitted for inspection and criticism before they are finally set up for assessment, and the law should require the courts to recognize the assessment records and their evidence of relativity as acceptable evidence.

The main features of an expert revaluation of real estate in a community may be briefly outlined as follows:

1. All value is relative. The wholesale appraisal of real estate in a community for tax assessment purposes requires the use of relative processes of appraisal of similar value-factors in all properties and the computation of the value-effect of variable factors.

2. The comparative valuation of land in any community can be accomplished by expression of the judgment of an assessor, assisted by committees of taxpayers, and guided by technicians, in the expression of unitary judgments. When tentative judgment of land unit prices has been marked upon the various block frontages in a community map and published for general discussion, it will be found that taxpayers, notwithstanding individual bias, will give valuable information in modifying or correcting the tentative prices. The assessor will thus be able to present a consensus of community opinion as to the comparative street values at different land locations throughout the community for a uniform unit of quantity—one foot front 100 feet deep—or other uniform quantity.

3. The value-effect of variations in depth for lots which have a single-street influence only may be computed by a depth percentage showing receding values from street frontages. Lots which are of greater than single-street value because of corner advantages may be computed as to enhancement over single-street values by mathematical corner tables. The additional value-effect of alleys, waterways, railroad accessibility or other enhancing factors may be separately computed and added to the single-street values, with the result that the normal value of each lot in the community may be appraised on a comparable basis with all other lots. Topographical irregularities or other detracting influences which lessen the useful value of a particular lot may be separately considered, and proper deduction made by special judgment to show the amount of lessened usefulness due thereto.

4. Buildings may be measured, architecturally described, computed as to unit areas, and appraised by the expression of judgment of the value of an agreed unitary quantity, and may be depreciated by judgment as to the accrued effects of the depreciating causes of mechanical deterioration, obsolescence and lack of utility. Special valuation tables may be prepared to show the unitary costs of

buildings which may be reduced to type, with additions or deductions for lack of conformation to types. Special buildings should be separately and individually appraised by expert judgment.

5. The sum of the values of the land and buildings combined, as thus competently appraised, should yield a fair valuation for each property as a whole.

It may be noted that assessment by systematic processes is essential to the equalized operation of any system of economic taxation. The primary purpose of systematic valuation is to equalize as between different items of like property; but systematic appraisal would be particularly essential under a discriminative law designed to tax land higher than improvements, for in such a case it is equally important that the discriminations should be made by valuation processes rather than by juggling tax rates on valuations known to lack uniformity. The purpose of the so-called Pittsburgh plan was to reduce taxation upon buildings to 50 per cent of land taxation; but the actual total discrimination is negligible—not more than 2 or 3 per cent the last time I checked it, and this discrimination was never more than 7 per cent, as compared with the total land and building value assessments prior to the initiation of the Pittsburgh plan.

One acknowledged effect of installation of systematic assessment is stabilization of the real estate market. With confidence developed by the public plan of appraisal the transactions of buyers and sellers are regulated by prices which are generally agreed to represent useful values. The municipality can collect the taxes needed to pay the cost of government on a basis acknowledged to be fair to all taxpayers. This process of assessment is an approach to the scientific democracy which all good citizens hope for.

CHAPTER XVIII

RELATION OF TAX COLLECTION METHODS TO DELINQUENCY

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THE general property tax, being the mainstay of the revenue systems of most local governments, needs to be a reliable tax. If budgets are to be balanced with any degree of facility and municipalities are to have a steady flow of funds to meet their financial obligations, each property tax levy needs to be promptly collectible and highly collectible. Ideal dependability calls, first, for the largest possible collection of each tax levy within the fiscal year it is designed to finance; second, for a rapid and orderly realization of tax arrears; and, third, for close to 100 per cent ultimate collection.

That a rather disconcerting amount of unreliability in the property tax developed in the past ten years, however, is a matter of common knowledge; and the fact that collections this year are back to normal, on the average, should not be permitted to obscure the actual or potential unreliability that still exists.

VARIATIONS IN DELINQUENCY

One of the most significant characteristics of this continuing unreliability is the wide variation in the extent to which it manifests itself in different jurisdictions. This

would be logical in communities representing extremes of economic obsolescence and business recovery, but somewhat surprising when it appears in any fairly homogeneous group of cities. Yet here is the situation as it existed in 1938 in 150 cities of over 50,000 population. While the average year-end delinquency on the current levy was 10.7 per cent, the range was from 1.3 per cent to 35.8 per cent. For 100 of these cities total collections of both current and delinquent taxes averaged 99.8 per cent of the current levy in 1938, but the range was from 80.3 per cent to 121.9 per cent. Again, the accumulation of all delinquent taxes at the close of 1938 averaged 43.1 per cent of a year's levy for 118 of these cities, but the range was from 4.7 per cent to 190.7 per cent. With respect to long-range collectibility, taxes levied for the year 1935 in 90 cities remained 3.6 per cent uncollected, on the average, at the close of 1938. However, in ten of these cities less than one per cent remained outstanding, while at the other extreme the ratio ran as high as 28.5 per cent.

Causes of Variations

The causes of these tremendous variations in dependability, needless to say, are manifold. They involve such factors as the economic status of the community, the weight of the tax burden, the fairness with which property is assessed, the identity of the major taxpayers, the nature of the property assessed, and the amount of chronically delinquent property which has been removed from the tax rolls through foreclosure, to mention the more important. But one factor which is universally present, and which no community can afford to overlook, is the degree of efficiency exercised in tax collection administration.

Efficient collection methods during the depression period

produced better results in many communities than might have been anticipated from the economic circumstances which prevailed; inefficient methods often had a pronouncedly opposite effect. And certainly one valuable product of the financial stringency which most municipalities encountered was a widespread and partially successful movement to improve tax collection administration and procedure. While it is virtually impossible to measure precisely the influence of efficient collection methods, because of the multiplicity of factors which determine tax collection results, the part which they can play is susceptible to demonstration in a fairly concrete manner.

As a preliminary to such demonstration, however, the essentials for efficient collection administration should be mentioned. These should include, of course, sound legal procedure, such as set forth, for example, in the model tax collection law drafted by the National Municipal League. The main features include a system of installment payments well synchronized with the fiscal year; moderately heavy penalties to encourage prompt payment; interest charges high enough to discourage protracted delinquency; provision for regular tax sales soon after the final delinquency date; and provision for final enforcement in a reasonable period of time through effective, inexpensive foreclosure proceedings.

The lack of sound tax collection laws in many jurisdictions is conspicuous, as is also the fact that the temporary weakening of laws by many legislatures has had a demoralizing effect. But poor tax collections have been fully as much the result of failure of local officials to enforce the laws and to use businesslike collection methods. On the other hand, there are many examples of officials who, by their ingenuity, have obtained good results in spite of legal

handicaps. Businesslike collection administration calls for such tactics as the placing of bills in the hands of taxpayers well in advance of the due dates, follow-ups of delinquent taxpayers, maintenance of efficient billing, recording and accounting systems, study and classification of types of property owners and property, interviews with persons delinquent on their payments, and efforts at what might be called taxpayer education.

Results of Improved Tax Collection Methods

Leaving theory for practice, what are some of the results of traditionally efficient methods and of recently improved methods of tax collection administration?

Of 150 cities of over 50,000 population at least 23 closed 1938 with less than 5.5 per cent of their current tax levies uncollected as compared with a median ratio for the 150 of twice that amount. Economic and other factors entered the picture, to be sure, but there is some significance in the fact that most of the group follow efficient, rigid methods of tax collection. Ten of the 23, in fact, were California cities, none of which had abnormal tax delinquency in the depression despite the deflation of a hectic real estate boom in the southern part of the state. The explanation seems to rest partially in sound taxpaying traditions, built up over a period of years under businesslike collection systems, and impervious both to business recessions and to the action of the state legislature in waiving penalties.

These same 150 cities sustained an average current tax delinquency of 10.7 per cent in 1938—a return almost to the fairly normal 10.3 per cent of 1930. But 63 of the 150 bettered their 1930 records. Various factors enter into the explanation of this constructive development, but changes in tax collection procedure or more vigorous collection

methods were either a contributing or dominating influence in a majority of the group. Take, for illustration, the situation in the 13 New Jersey cities which comprise a fifth of the group showing improvement over 1930. These cities had traditionally borrowed against taxes instead of pressing for their prompt collection. Their average year-end delinquency in 1930 was 29.6 per cent; by 1933 it was 43.3 per cent; and by the following year drastic action was necessary to avert financial collapse. In conjunction with other steps toward rehabilitation, quarterly tax payments were instituted beginning early in the fiscal year; penalties were increased and enforced; tax sales were held, the first in most instances in years; various other improved collection methods were adopted; and in 1938 the average year-end delinquency was 22.5 per cent—seven whole percentage points better than in 1930.

Characteristic of what happened in New Jersey was an episode in the city of Trenton. This city sought the consent of the State Funding Commission for the sale of a large deficit funding and refunding bond issue. Consent was withheld, however, until the city should hold a tax sale, which it had not done in years. When the tax sale was proposed, so great was the rush of property owners to pay their arrears that it held up the preparation of the list of delinquent property and delayed both the tax sale and the bond offering for several weeks.

Reference to tax collection reform in New Jersey prompts comment on another means of improving tax collections only indirectly related to collection methods. It involves an effective procedure for balancing budgets through realistic rather than imaginative estimating of revenues. When budget makers are required to estimate the income from taxes on the basis of actual experience, to provide for the

deficit of one year in the budget of the following year, or to set up reserves for slowly collectible taxes, the strongest leverage is provided for vigorous tax collection efforts. The alternative to good tax collections then becomes an increased tax levy, an exigency which even the professional politician likes to avoid. In New Jersey and in other jurisdictions where such methods of budgeting have been adopted, observers have noted more strenuous efforts to collect taxes.

One of the astounding revelations of depression experience was the degree to which even the most rudimentary of efficient tax collection methods had been ignored. It was not uncommon, even in sizeable cities, to find no tax bills sent to property owners, to find taxes carried on the books and in the balance sheets dating back almost to the Civil War, to discover not only no effort to collect back taxes but no compiled record of property owners' delinquent tax obligations, and to find that such search was made and the bill settled only when property changed hands. One illustration will suffice. Lincoln, Nebraska, for the past 50 years has used a manual system of tax accounting, preparing a tax book annually. Taxpayers had to call at the city hall to learn the amount of their current tax bills, and wait while records were searched for arrears. With the 1939–40 levy, which went into collection October 1, 1939, a new mechanical accounting-billing system is being used. Taxpayers were billed in advance, and October, 1939, collections were the largest for that month in the history of the city.

How special efforts by officials can counteract legal handicaps may be illustrated by recent developments in Fort Worth, Texas. The state law under which property taxes are enforced in Texas is cumbersome, calling for reduction

of the lien to judgment through personal suit, and then the sale of the judgment. The city of Fort Worth had total current and delinquent tax collections amounting to 92.9 per cent of the levy in 1936–37. In 1938 a special delinquent tax division was set up and total collections in 1938–39 rose to 99.1 per cent of the levy. Similar devices are utilized in certain other Texas cities, with results which indicate their efficacy.

Lest this illustration from Texas be interpreted as an intention to underestimate the value of effective tax laws, let me cite the brief and checkered career of one ill-fated local law. Prior to 1932 the city of New Rochelle, New York, held no tax sales as it had no law authorizing such a procedure. In that year, however, the city council passed a tax lien law and tax sales were held under it until its constitutionality was contested and it was ruled out by the court in 1938. The significance of this ephemeral bit of legislation rests in what it accomplished for tax collections while it lasted. In 1933, the worst year of the depression for tax collections generally, New Rochelle's total collections rose to 99 per cent of the year's levy; they remained at this level during the years of tax sales; and then dropped to 94 per cent in 1938 when the law was annulled.

One opportunity for good business management afforded by the tax collection process appears to have been largely overlooked. That is the opportunity for taxpayer education, for overcoming the often irrational resentment at the tax bill. Your monthly bill from the department store is sweetened by accompanying illustrations of the attractive bargains being placed at your disposal. Along with your gas bill and electric bill come insinuating little folders about how many pies you can bake or radio-hours you can operate for a nickel or for the price of a package of cigarettes. But

the tax bill usually arrives in all its formidable austerity, without a suggestion of what, if anything, you are getting for your money.

Here too, however, a bit of ingenious salesmanship is beginning to inject itself. It is no longer uncommon for the reverse side of the tax bill to carry a budget summary for the taxpayer to puzzle over. And in a few cities officials are seizing the opportunity to send along with the tax bills attractively prepared leaflets explaining in simple language and figures the changes in the current budget, or listing and showing the cost to the average taxpayer of the various municipal services rendered. No statistics can be cited to demonstrate the effect of such procedure on tax delinquency, but there is evidence that it helps to engender understanding and good will.

Good tax collection methods certainly are no cure-all for the weaknesses and inequities of municipal revenue systems, but a combination of sound procedure and efficient administration goes far in lessening the hazards and uncertainties of municipal finance. Among the perquisites that are forthcoming are a more prompt and steady realization of income from tax revenues; a reduction in ultimate losses; less necessity for guesswork in the making of budgets; a more realistic understanding of a community's economic characteristics, resources and trends; and an opportunity, not necessarily to make taxpayers like to pay taxes, but to dislike less to pay them.

CHAPTER XIX

IMPROVEMENTS IN FORECLOSURE PROCEDURE

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There is little romance in a tax law. The entire process of taxation, particularly tax collection and enforcement, may be summed up in four words—due process and dollars.

In considering the problem of tax collection and enforcement, municipal officials and lawyers have put so much emphasis on due process that the practical dollar problem in tax collection has been neglected. Too much attention has been paid to due process and too little attention to dollars. As a result thereof tax collection, and particularly the enforcement of the collection of delinquent taxes, has become a major administrative problem in New York State. Millions of dollars in unpaid taxes and hundreds of millions of dollars in assessed valuations are at stake.

History of New York Foreclosure Law

The problem reached its present alarming proportions because the existing legal machinery for delinquent tax enforcement is unsatisfactory. The two major remedies, the tax deed title proceeding and the tax lien foreclosure action failed to meet the problem. Tax deed titles are subject to attack because of the possibility of procedural defects. The title though good isn't marketable. Tax lien foreclosure is so costly that it is rarely used except against im-

proved properties or properties having value far in excess of the accumulated taxes. Neither system affords a remedy which will enable officials to restore to the tax rolls the hundreds of thousands of unimproved parcels scattered all over the state, many of which had paid no taxes for 10, 15 and 20 years.[1]

In addition to a lack of uniformity of procedure, the remedies available are so costly and cumbersome, and the possibility of error so great, that even the most conscientious public officials felt that tax lien foreclosure was a hopeless and impossible task. This was the general attitude, even though the same officials knew that unless taxes were paid, and delinquent properties restored to the rolls, the financial structure of every municipality in this state would be seriously undermined.

In 1936 the New York State Conference of Mayors adopted a resolution petitioning the State Tax Commission to join with the Conference in making a study of tax lien foreclosure procedure.[2] Several meetings were held in 1936, and in January of 1937, the New York State Bar Association joined forces with the Tax Commission and Conference Committee in attempting to draft legislation which would provide a simple and inexpensive tax lien foreclosure system.[3]

At the outset the committee determined that it must adjust the law to the realities of the case. "The necessity

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[1] *See* Philip H. Cornick, *Report to State Planning Council,* 1938, pp. 106 ff.

[2] *See* address by Samuel Levy, *Municipal Problems, 1937,* State Conference of Mayors, p. 41.

[3] The subcommittee drafting the legislation consisted of Mark Graves, President of the State Tax Commission, Mortimer Kassell, Counsel to the Tax Commission, William Davidson, County Attorney of Westchester County, Samuel Levy, Village Attorney of Freeport, Arnold Frye, Chairman of the State Bar Association Committee on Municipal Law, and George Xanthaky, Attorney, Long Beach, N. Y.

of money for the support of government" was the primary problem. The committee proceeded on the premise that there is a legal and practical distinction between a private and municipal tax lien buyer. One is a voluntary investor for profit. The other an involuntary bidder compelled by law to protect its own taxes. One buys the cream, the other is left with the skimmed milk—liens on vacant, unimproved submarginal land. The mortgage foreclosure remedy, costing at least $125 per action, might be a fair remedy for the private lienor; but it was far too expensive for a municipal lienor.

It was felt that a remedy must be devised for municipalities which would eliminate the necessity of title searches, personal service, referees' fees and huge advertising costs; that an action *in rem,* directed against the land, as distinguished from the owner of the land, and in which there would be no personal judgment, was the solution to the problem.

As a result there was introduced in the 1938 session of the legislature the so-called Buckley-Flynn tax bill (Senate Int. 993). The bill passed the Senate but never got out of committee in the Assembly. Despite the temporary setback in the 1938 session of the legislature, the Mayors Conference and the Committee continued its work, and in 1939 the final effort of the Committee represented by the Stagg-Whitney tax bill (Senate Int. 1582, Pr. 2552), was introduced and passed in both houses of the legislature and became Chap. 692 of the Laws of 1939.

The Stagg-Whitney bill repeals old Article 7-a of the tax law and re-enacts a new Article 7-a. The procedure is wholly optional and becomes effective only in the event that the governing body of the municipality formally elects to use its provisions.

Provisions of New Foreclosure Law

The bill is divided into four titles. Title 1 contains the definitions and the method by which the election to use its provisions must be exercised. Perhaps the most important definition in this title is that which describes a tax lien as "any unpaid tax, assessment or other legal charge, which is a lien on real property whether or not the same be evidenced by a 'transfer of tax lien,' a 'tax sale certificate,' a 'tax transcript,' a 'certificate of tax sale,' or any other written instrument." This definition is sufficiently broad to cover any debt or charge owed to the municipality regardless of the name or technical description thereof used in any local or general tax statute.

Title 2 relates to the foreclosure of a tax lien as in an action to foreclose a mortgage. It is practically a re-enactment of old Article 7-a of the tax law, and provides the machinery for the foreclosure of a tax lien as though it were a mortgage. However, several important procedural improvements may be found in the title. Their purpose was to cut costs and strengthen title. The remedy is available to private as well as public tax lienors.

In Rem Foreclosure Procedure

Title 3 of the bill provides an entirely new procedure for tax lien foreclosure by an action *in rem*. Only a municipality may use this title and then only when the tax lien involved is four years old or more. The theory of the action is that the municipality shall proceed against the land and not the owner. No personal judgment can be obtained. The effect of the action is to vest a title in fee in the foreclosing tax district. Under the action *in rem* no tax title searches are required; no summons and complaint

need be served personally; there are no referees' fees or filing fees. The action is simple, summary and inexpensive.

In adopting this remedy the committee considered that the legislature possesses plenary power to make any changes which it deems advisable in the method of collecting taxes,[4] and that the taxpayer has no vested rights in a purely procedural statute designed to enable a municipality to collect its taxes.

Since the formation of the republic "the most summary methods of seizure and sale for the satisfaction of taxes and public dues have been held to be authorized, and not to amount to the taking of property without due process of law." [5]

The collection of delinquent taxes by foreclosure *in rem* has been held by the United States Supreme Court to be constitutional and not in violation of the due process clause.[6]

The procedure in Title 3 follows the general plan of the tax enforcement statutes used in Washington, Nebraska and Minnesota. All three states enforce tax liens by action *in rem.* All three statutes have been litigated before the United States Supreme Court, and all three have been held constitutional.[7] The Supreme Court of the United States, in upholding these statutes cited Cooley on Taxation (2nd ed. 527) as the authority for the proposition that

> Proceedings of this nature are not usually proceedings against parties; nor, in the case of lands or interests in lands, belonging to persons

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[4] *Nassau Co.* v. *City of Long Beach,* 272 N.Y. 260.

[5] *Leigh* v. *Green,* 193 U.S. 79; *Murray* v. *Hoboken Land Co., Inc.,* 18 How. 272; *Henderson's Distilled Spirits,* 14 Wall 44; *Davidson* v. *New Orleans,* 96 U.S. 97.

[6] *Leigh* v. *Green,* 193 U.S. 79 (1904).

[7] *Leigh* v. *Green* (supra); *Winona & St. Paul Land Co.* v. *Minnesota,* 159 U.S. 537; *Ontario Land* v. *Wilfong,* 223 U.S. 655.

unknown, can they be. They are proceedings which have regard to the land itself rather than to the owners of the land; and if the owners are named in the proceedings, and personal notice is provided for, it is rather from tenderness to their interests, and in order to make sure that the opportunity for a hearing shall not be lost to them, than from any necessity that the case shall assume that form.

With this practical and legal background in mind the provisions of Title 3 of the Stagg-Whitney bill seem much less drastic.

Filing List of Delinquent Taxes

The bill provides (section 165) that any municipality owning a tax lien which has been due and unpaid for a period of four years shall have the right summarily to foreclose the lien by an action *in rem*. The municipality initiates the action by causing the tax collector to prepare a list of all property on which there are unpaid tax liens at least four years old. Each parcel is numbered serially and as to each parcel the list, known as the "List of Delinquent Taxes," contains:

1. A brief description of the property;
2. The name of the last known owner as the same appears on the last assessment roll;
3. A statement of the amount of each tax lien and the interest and penalty rates and the dates from which such interest and penalties should be computed.

The list must be verified by the collecting officer. Certified copies must be filed in the office of the county clerk, the attorney for the tax district, and in the office of the collecting officer of any other tax district having the right to assess any of the parcels described in the list.

The filing of the list in the office of the county clerk constitutes and has the same force and effect as the filing and

recording of an individual and separate notice of pendency of action and as the filing in the county or Supreme Court of such county of an individual and separate complaint by the tax district against the real property described therein (sec. 165a). Thus, if the list contained 4,000 separate parcels, it would constitute as to each of the 4,000 parcels an individual notice of pendency of action and complaint.

The county clerk must receive, file and index the list of delinquent taxes and charge a fee of $10 except in counties having a block and section system. Instead of 4,000 filing fees there is but one filing fee; instead of 4,000 complaints there is one list which constitutes a complaint as to each and all of 4,000 parcels.

But the mere filing of the list of delinquent taxes does not cut off the owners' rights. Even though the legal period of redemption has passed, the owner is given another and final chance to pay his taxes and redeem his property.

Notice of Foreclosure

The statute provides that the foreclosing tax district must, after filing the list, publish a public notice of foreclosure for at least six weeks in two newspapers published in the tax district (sec. 165b). In effect the notice is a short complaint in a foreclosure action. It is notice to all the world that the list of delinquent taxes has been filed; and that all persons having or claiming to have an interest in the lands described therein may see and examine the list which has been filed in the office of the county clerk and in the office of the collecting officer of the tax district, up to and including a fixed date named in the notice. The date must be at least seven weeks from the date of the first publication of the notice; and is fixed as the last day of grace for redemption.

Persons having any interest in the lands contained in the list have three courses open to them. They may pay up and redeem their property. They may file an answer setting forth their defense or objection to the foreclosure; or they may default. In the event of failure to pay or answer, judgment may be taken by default.

To further protect the owner and give him every reasonable notice, the collecting officer is required to mail a copy of the public foreclosure notice to the last known address of each property owner whose lands are included in the list. Mortgagees or lienors may file a notice with the collecting officer requesting the collecting officer to mail to them a copy of any notice required under the statute. In that event, notice of the foreclosure is mailed to them as well as the owner of record.

The provisions of this section, the committee felt, represented the proper combination of theory and practice, of due process and dollars. Instead of publishing individual foreclosure notices in 4,000 actions, due process is complied with by one notice, less than a column long, published for six weeks in two newspapers, together with a copy thereof mailed to the last known owner as his name appears upon the last assessment roll. The owner who hasn't paid taxes for four years knows it. He knows too, that if he doesn't pay he will lose his property. The notice provided by the statute reminds him of his delinquency, and the result which will follow if he doesn't pay up.[8]

The mere fact that notice under the old system cost the municipality the very minimum of twenty dollars while notice under the *in rem* proceeding costs about a dime, does not make the *in rem* notice any the less constitutional. Due

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[8] *Ontario Land* v. *Wilfong,* supra.

process is measured not by the cost of the notice; but by its sufficiency in apprising the owner that he will be divested of his ownership unless he pays his taxes. It is a well settled principle of constitutional law that "the process of taxation does not require the same kind of notice as is required in a suit of law, or even in proceedings for taking private property under the power of eminent domain." [9]

In the event that answer is made the defendant is granted an absolute right of severance. A statutory preference over all other causes and actions is granted by section 165-f. The court, or an official referee thereof, must summarily hear and dispose of the issues. If the court finds that the defendant has an interest, it must make a final judgment directing a sale of the property in every case, except where the defendant is another tax district. In such a case the municipalities involved may enter into the agreements permitted by section 165-h, subdivision 3.

Under this section the districts may provide by agreement:

1. For a conveyance without sale to one of the districts free and clear of the liens of the other districts;
2. A conveyance without sale to one of the districts subject to the liens of the other districts;
3. In the absence of such agreements, the court must make a final judgment directing a sale. In such a case the sale must be conducted by the collecting officer after public notice for three weeks in one newspaper in the district. The collecting officer can receive no fee or compensation for the service.

The court, under section 165-h, subdivisions 1, 5 and 6, is empowered to determine and enforce in all respects the rights, priorities, claims and demands of the parties to the

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[9] *Bell's Gap R. Co.* v. *Pennsylvania,* 134 U.S. 239. *Ontario Land* v. *Wilfong,* 223 U.S. 543.

action including the defendants among themselves, and to determine upon proof and make findings upon such proof as to whether there has been due compliance by the tax district with the provisions of the statute. The final judgment directs the collecting officer to prepare, execute, and record the deed conveying title to the parcels concerned. Upon execution of the deed the foreclosing district or grantee is seized of an estate in fee simple absolute in such parcel and all persons including the state, infants, incompetents, absentees and non-residents, are forever foreclosed of all their right, title, interest and equity of redemption in the property. The only exception is when conveyance is pursuant to agreement between the tax districts and the title is made subject to the taxes of other tax districts.

Thus, the foreclosing tax district ends up with a title that is based upon a judicial decree which not only settles the rights of the parties, but which contains findings of fact based upon proof, that there has been due compliance with the procedural provisions of the statute. The proceeding vests a good and, what is more important, a marketable title in the tax district. It overcomes the most serious objection to the old tax deed, namely, that it vested a good title in the grantee, but one which was unmarketable since it was subject to attack because of procedural defects.

Other General Provisions of Law

Title 4 of the bill contains some 14 general provisions. This title and Title 1 become effective by operation of law in any tax district which elects to adopt either Title 2 or Title 3 or both of the act. The more important general provisions are:

Section 166-a which permits tax districts owning liens on the same land to make agreements between themselves

with regard to the disposition of such liens and the disposition of the proceeds of sale. This provision was inserted because of the great practical difficulties presently confronting overlapping tax districts because of the lack of any statutory power for such district to treat their respective interest in the property in a sensible businesslike manner. The agreement provision has worked admirably in Westchester County.

Section 166-b enables a tax district lacking statutory authority to protect its tax liens in a proper case and if necessary enables it to provide funds therefor.

Section 166-e enables owners, mortgagees, and lienors to register their names with the tax collector and to receive a notice of any tax sale or process affecting such person's property. This provision was inserted to protect the interest of owners and mortgagees and particularly the savings banks.

Section 166-f makes it mandatory for municipalities to hold annual tax sales and provides that in the event that there is no bid or no legally acceptable bid that the tax district, by operation of law, becomes the owner of the lien. This provision prevents the disastrous results which follow from either the intentional or inadvertent failure of the collector to bid in property at a tax sale when there is no bid.

The third subdivision of the section prevents merger of tax liens and will relieve municipalities of the unnecessary expense of re-offering municipally owned tax liens at subsequent tax sales, and it provides that the tax district is deemed to have bid in such liens as though the same had actually been offered for sale.

Section 166-j is an extremely important section. It pro-

vides that when a tax district acquires title through foreclosure under this bill, the land, unless used for other than a municipal purpose, is deemed to be held by the district for a public use for a period of two years from the judgment. This removes the great objection many districts have to foreclosure, namely, that they will be forced to pay taxes to overlapping districts on land which is nonproductive. The municipality is given a reasonable time, two years, to dispose of the property. After that the land must be taxed. This will force municipalities to make a genuine effort to restore the land to the tax rolls as income producing property.

Section 166-l confers upon any tax district the statutory right to accept a deed from an owner of a lien in lieu of foreclosure. This is a sound practical provision which will result in a saving of hundreds of thousands of dollars. Owners frequently are willing to turn over a deed to the municipality but municipalities are reluctant to accept the same because of lack of statutory authority and the fear that they will not be able to insure the title.

Comparison of Costs

I know you will forgive me at this point if I compare costs under the old and new remedies. The foreclosure costs listed below are taken from the official records of a city operating under a statute which eliminates referees' fees and which cuts costs to the very minimum. The costs are taken from a typical action in which no answer was submitted and judgment taken by default. All parties were personally served and there was no additional expense of service by publication. The figures speak for themselves. No further explanation is necessary.

TABLE OF COSTS

	Mortgage Foreclosure Plan	*In Rem Plan*
Title search	$12.50	$00.00
Notice to redeem	5.00	.25
Tax search	1.00	1.00
Continuation title search	3.50	0.00
Continuation tax search	1.00	0.00
Serving summons and complaint	5.00	.25
Advertising fee	28.00	.10
Legal fees	45.00	3.00
	$101.00	$4.60

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